FINANCIAL HISTORY

The magazine of the Museum of American Finance

Financial Discrimination and Innovation

Deflation, Up Close and Personal

City of Debtors

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FINANCIAL HISTORY

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in association with the Smithsonian Institution

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MUSEUM OF AMERICAN FINANCE

Smithsonian Affiliate

IN THIS ISSUE FEATURES

IN THIS ISSUE DEPARTMENTS

ON THE COVER

Customers wait in line at the Dunbar National Bank in Harlem, New York, January 7, 1933. The bank was owned by African Americans and served the local Black community. See related article, page 12.

Collaborations and Partnerships Bring MoAF Library and Collection Outside New York

Message to Members

David J. Cowen | President and CEO

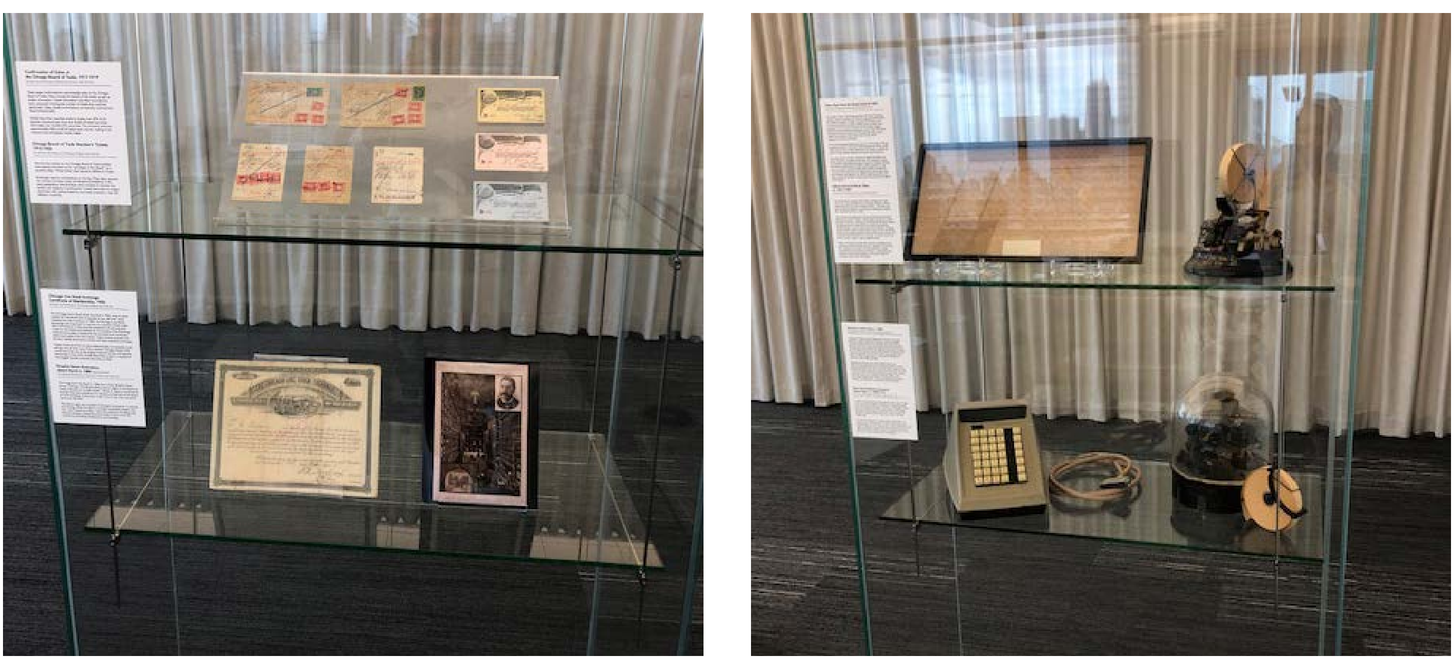
This summer, our Board and staff have focused on innovative ways to bring our programming and collections to the public while we continue to look for a more permanent home. One exciting development is that our library collection will soon be on loan to the American Institute of Economic Research (AIER), which has a state-of-the-art climate controlled library at their 100-acre facility in Great Barrington, MA. We will be moving our roughly 10,000 volume library there this summer, where AIER will fully catalogue it and make it accessible to scholars. The library will be on loan to AIER for an initial period of five years, beginning this month.

Also this summer, we loaned several objects for display at Citadel Securities' global headquarters in Chicago, as they have repurposed one of their floors into an area that includes historical displays. The display—presented in collaboration with the Museum of Science and Industry, Chicago—highlights the city of Chicago's financial history along with objects representing the evolution of financial technology.

We will also be installing at Paypal's New York City and San Jose headquarters the electronic version of our exhibit, "America in Circulation: A History of US Currency Featuring the Collection of Mark Shenkman," which was on display at the Museum from 2015–2018. This exhibit is also available online at money.moaf.org.

The summer session of our MFA Boot Camp, a new edition to our educational programming in 2019, ran from August 5–8 at 25 Broadway in New York. We will also offer two sessions of the Museum Finance Academy (MFA) in the fall, on Wednesdays and Thursdays after school from September 25 through November 14. This year, we will award two MFA scholarships to the top achievers, with the first place recipient earning $5k and the second place recipient earning $2.5k.

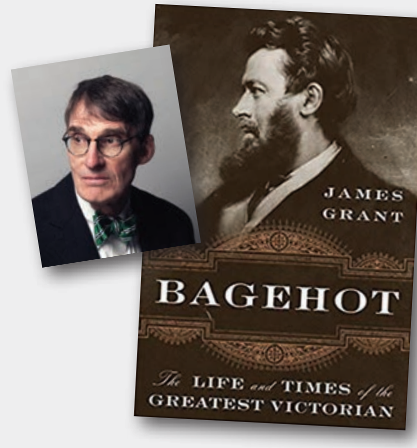
Our fall events line-up is also taking shape, and as you can see on page five, we have scheduled four Evening Lecture Series events: a panel event on "Corporate Sustainability" (Sept 19), James Grant (Sept 25—see article, page 32), Joe Ricketts (Nov 6) and a film screening of "In Money We Trust?," followed by a fireside chat with Steve Forbes (Nov 11). Our Lunch & Learn Series will feature programs with author Shennette Garrett-Scott (Oct 23—see article, page 20) and former *New York Times* reporter Ralph Blumenthal (Oct 29). As always, MoAF members receive free admission to Museum events, plus one free walking tour per year. We hope to see you there. $



At Citadel Securities' global headquarters in Chicago, the Museum of American Finance is currently exhibiting artifacts from its collection in collaboration with the Museum of Science and Industry, Chicago. The display highlights the city of Chicago's financial history along with objects representing the evolution of financial technology.

UPCOMING EVENTS CALENDAR


Joe Ricketts



Sep 19 Evening Lecture Series: "Corporate Sustainability: Is It Sustainable?" fireside chat with Martin Whittaker, CEO of JUST Capital, followed by panel discussion featuring industry leaders driving sustainability as an essential element of corporate purpose and a means to achieve transformative social impact. Sponsored by BNP Paribas and Moody's, and in partnership with the Fordham University Gabelli Center for Global Security Analysis. Talk followed by Q&A and reception. 6:00–8:30 p.m. Fordham University, McNally Amphitheatre, 140 West 62nd Street, NYC. General admission $35; MoAF members free. Reservations required.

Sep 25 Evening Lecture Series: James Grant on *Bagehot: The Life and Times of the Greatest Victorian*. Presented in partnership with the Fordham University Gabelli Center for Global Security Analysis. Talk followed by Q&A and reception. 6:00–8:00 p.m. Fordham University, McNally Amphitheatre, 140 West 62nd Street, NYC. General admission $25; MoAF members free. Reservations required.

Oct 23 Walking Tour: Women of Wall Street. 11:00 a.m.–12:30 p.m. Tour meets outside 48 Wall Street. $15 includes admission to the Lunch & Learn with Shennette Garrett-Scott.

Oct 23 Lunch and Learn Series: Shennette Garrett-Scott on *Banking on Freedom: Black Women in US Finance Before the New Deal*. Talk followed by Q&A and book signing. 12:30–1:30 p.m. 48 Wall Street, 5th Floor. General admission $5; MoAF members and students free.

Oct 27 Annual Great Crashes Walking Tour. 1:00–4:00 p.m. Tour meets outside 48 Wall Street. $15 per person.

Oct 29 Lunch and Learn Series: Former *New York Times* reporter Ralph Blumenthal on "Crash! The Stock Market Collapse of October 29, 1929 and the Rise of Fake Money (Scrip)." Talk followed by Q&A. 12:30–1:30 p.m. 48 Wall Street, 5th Floor. General admission $5; MoAF members and students free.

Nov 6 Evening Lecture Series: TD Ameritrade Founder Joe Ricketts on *The Harder You Work, the Luckier You Get*. Presented in partnership with the Fordham University Gabelli Center for Global Security Analysis. Talk followed by Q&A and reception. 6:00–8:00 p.m. The University Club, 1 West 54th Street (at Fifth Avenue), NYC. General admission $25; MoAF members free. Reservations required.

Nov 11 Evening Lecture Series: Documentary screening of "In Money We Trust?" followed by fireside chat with Steve Forbes and Elizabeth Ames, co-authors of *Money: How the Destruction of the Dollar Threatens the Global Economy—and What We Can Do About It*. Presented in partnership with the Fordham University Gabelli Center for Global Security Analysis. Program followed by Q&A and reception. 6:00–8:30 p.m. Fordham University, McNally Amphitheatre, 140 West 62nd Street, NYC. General admission $25; MoAF members free. Reservations required.

Nov 16 Walking Tour: History of Wall Street. 11:00 a.m.–12:30 p.m. Tour meets outside 48 Wall Street. $15 per person.

For more information or to register online, visit www.moaf.org/events.

Museum Acquires Two Aaron Burr Documents

By Sarah Poole, Collections Manager

The Museum of American Finance recently purchased for its permanent collection two compelling original documents related to Aaron Burr and the Manhattan Company: an 1802 account of Burr's debts to the Manhattan Company and an 1803 real estate indenture. Together, these pieces help tell the story of Burr's impact on early New York City finance and significantly expand the Museum's collection of documents detailing Burr's life.

In the 18th and 19th century, New York City suffered from numerous epidemics of deadly diseases, the most significant of which included yellow fever and cholera. In 1799, Aaron Burr founded the Manhattan Company under the auspices of building a water system to bring clean water to the city, which would create a more sanitary environment and curb disease. However, Burr included a clause in the company's charter that allowed it to engage in any legal business with its surplus capital, which enabled the opening of the Bank of the Manhattan Company.

The Manhattan Company only used $100,000 of its $2 million capital for a largely inadequate water system, while the remaining 95% was engaged in banking operations that competed with the city's only two other banks: Alexander Hamilton's Bank of New York and the New York branch of the Bank of the United States.

Although Burr had a lucrative career as a lawyer, he was a notorious over spender. In 1800, Hamilton wrote than then Vice President-elect Burr was "bankrupt beyond redemption except by the plunder of his country." The 1802 document recently acquired by the Museum illustrates Burr's financial problems by detailing all of his debts to the Manhattan Company at the time. His debts to the company totaled $64,908.63. Against this, Burr had assigned nine mortgages and a promissory note, but the total of the security was still $7,000 less than his debt.

The 1803 real estate indenture, which Burr signed, further exemplifies the Manhattan Company's banking endeavors. The indenture shows that he resold 20 lots in present-day Greenwich Village after the original buyer, Timothy Green, could not pay his mortgage to the Manhattan Company. After Green missed his first annual payment, Burr made the payment in his stead, and then 10 days later sold the same 20 lots to David Gelston.

Gelston was a merchant from Long Island who represented Suffolk County in the New York Provincial Congress (1775–1777) and the New York General Assembly (1777–1785). After moving to New York City in 1787, he worked as the Collector of the Port of New York from 1801 to 1821.

The Museum intends to feature both of these documents in its upcoming exhibit on New York water, in collaboration with the New York City Municipal Archives, which is set to open this fall. $

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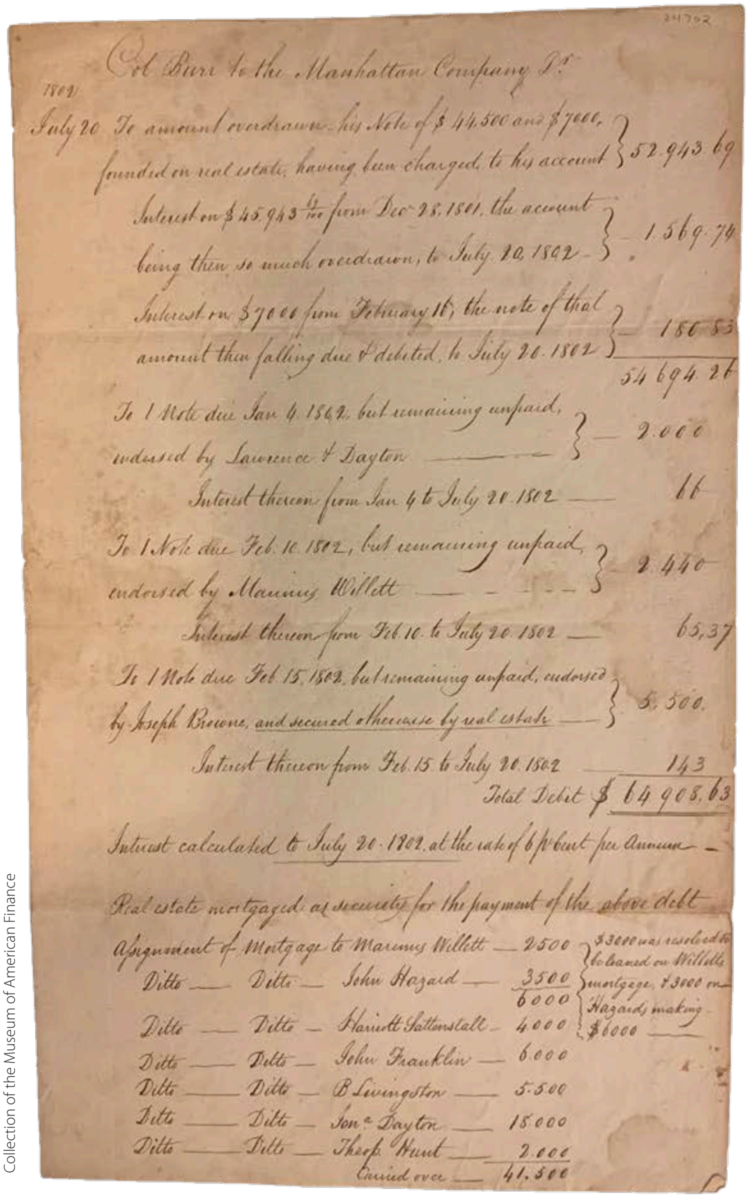


Col Burr to the Manhattan Company Dr.

1802

July 20 To amount overdrawn his Note of $44.500 and $7000, founded on real estate, having been charged to his account } 52.943.69

Interest on $45.943 from Dec 28, 1801, the account being then so much overdrawn, to July 20, 1802 } 1.569.74

Interest on $7000 from February 16, the note of that amount then falling due & debited, to July 20. 1802 } 180.83

54 694.26

To 1 Note due Jan 4 1802, but remaining unpaid, indorsed by Lawrence & Dayton } 2.000

Interest thereon from Jan 4 to July 20 1802 — 66

To 1 Note due Feb. 10. 1802, but remaining unpaid, endorsed by Marinus Willett } 2.440

Interest thereon from Feb. 10. to July 20 1802 — 65,37

To 1 Note due Feb 15, 1802, but remaining unpaid, endorsed by Joseph Browne, and secured otherwise by real estate } 5.500

Interest thereon from Feb. 15 to July 20. 1802 — 143

Total Debit $ 64 908.63

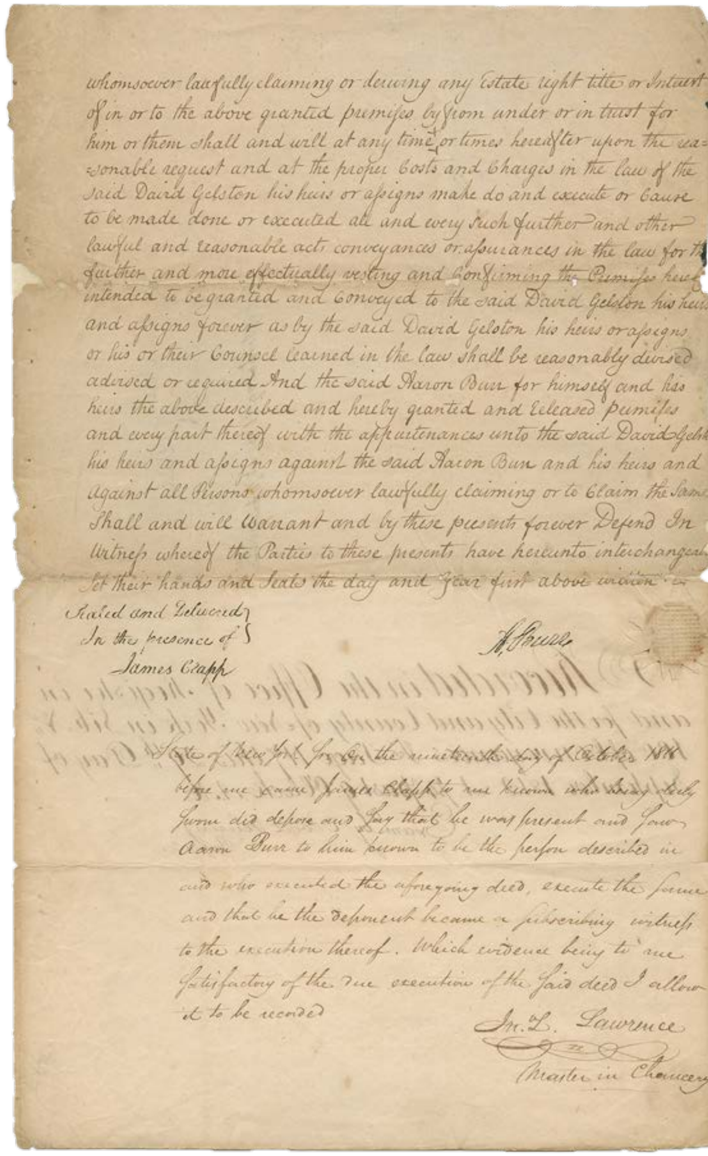
Interest calculated to July 20. 1802 at the rate of 6 p cent per Annum —

Real estate mortgaged as security for the payment of the above debt

Assignment of Mortgage to	Marinus Willett	2500	$3000 was resolved to be loaned on Willetts mortgage, & 3000 on Hazards, making $6000
Ditto — Ditto —	John Hazard	3500	
		6000	
Ditto — Ditto —	Harriott Saltonstall	4000	
Ditto — Ditto —	John Franklin	6000	
Ditto — Ditto —	B Livingston	5.500	
Ditto — Ditto —	Jon.a Dayton	15.000	
Ditto — Ditto —	Theop. Hunt	2.000	
	Carried over	41.500	

Collection of the Museum of American Finance

The full account of Burr's debts to the Manhattan Company as of July 20, 1802.



whomsoever lawfully claiming or deriving any Estate right title or Interest of in or to the above granted premises by from under or in trust for him or them shall and will at any time or times hereafter upon the reasonable request and at the proper Costs and Charges in the law of the said David Gelston his heirs or assigns make do and execute or Cause to be made done or executed all and every such further and other lawful and reasonable acts conveyances or assurances in the law for the further and more effectually vesting and Confirming the Premises hereby intended to be granted and Conveyed to the said David Gelston his heirs and assigns forever as by the said David Gelston his heirs or assigns or his or their Counsel learned in the law shall be reasonably devised advised or required And the said Aaron Burr for himself and his heirs the above described and hereby granted and Released premises and every part thereof with the appurtenances unto the said David Gelston his heirs and assigns against the said Aaron Burr and his heirs and against all Persons whomsoever lawfully claiming or to Claim the Same Shall and will Warrant and by these presents forever Defend In Witness whereof the Parties to these presents have hereunto interchangeably set their hands and Seals the day and Year first above written

Sealed and Delivered In the presence of James Clapp

A. Burr

State of New York ss On the nineteenth day of ... before me came James Clapp to me known who being duly sworn did depose and say that he was present and saw Aaron Burr to him known to be the person described in and who executed the aforegoing deed, execute the same and that he the deponent became a subscribing witness to the execution thereof. Which evidence being to me satisfactory of the due execution of the said deed I allow it to be recorded

Jn. L. Lawrence

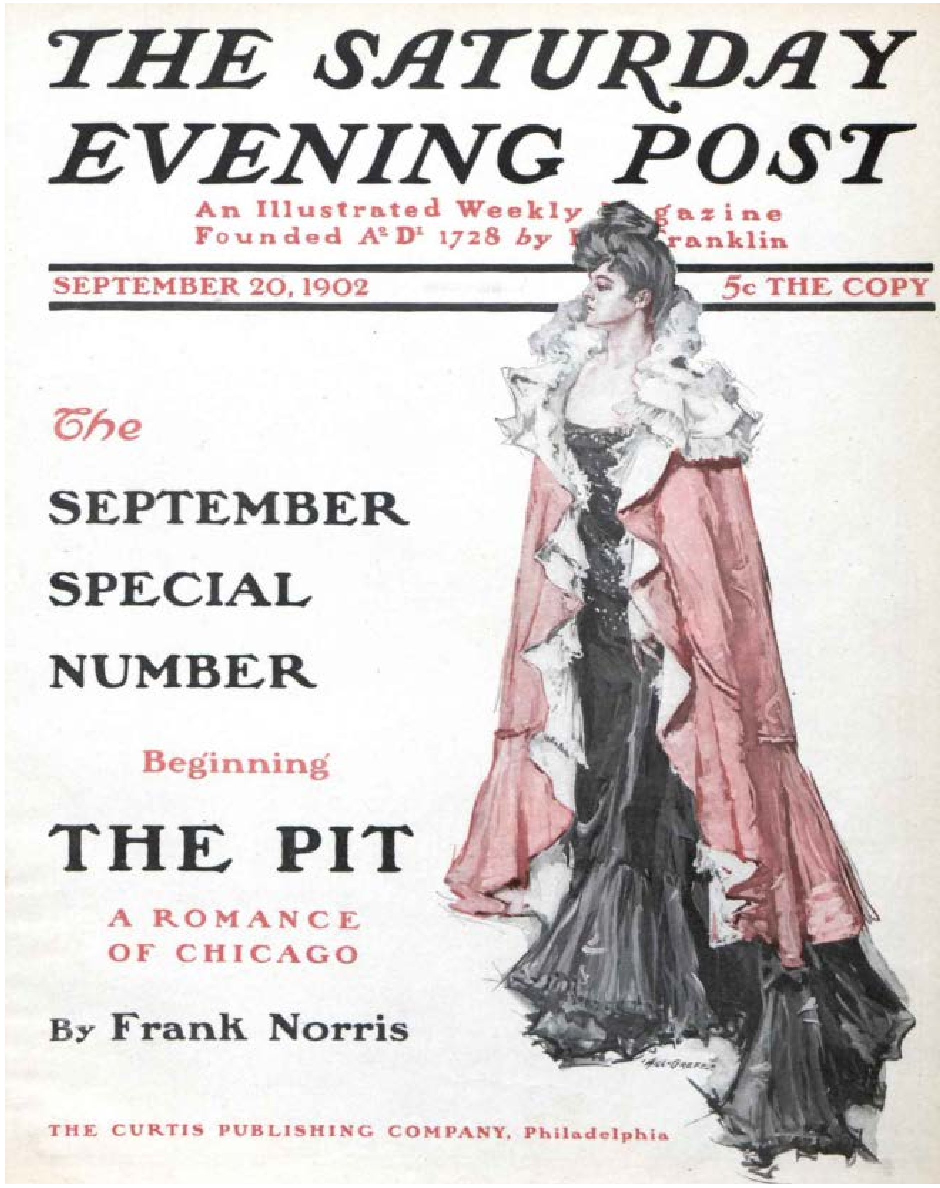
Master in Chancery

Collection of the Museum of American Finance

1803 real estate indenture signed by Aaron Burr.

Frank Norris's *The Pit:* An Unfinished Trilogy

By Brian Grinder and Dan Cooper



Cover of the September 20, 1902 issue of *The Saturday Evening Post,* featuring Frank Norris's *The Pit.*

It was an enormous success, flying off bookstore shelves before they could be restocked. Some believe it inspired the Parker Brothers card game called Pit. At the very least, it helped the firm create its biggest moneymaking product to date. It was the basis for two Broadway plays, as well as one of D.W. Griffith's most important silent films, *A Corner in Wheat.*[1] Serialization in *The Saturday Evening Post* yielded a $3,000 windfall for young Frank Norris and allowed him to finally make a living as an author. But by the time *The Pit: A Story of Chicago* was published in January of 1903, Norris was dead.

Frank Norris, a native of Chicago, was an author and journalist who covered the Boer War in South Africa and the Spanish-American War in Cuba. He wanted to make a living as a full-time author, and although he came from a fairly well-to-do family, he was forced to work part-time as a manuscript reader for Doubleday, Page and Company in order to make ends meet. Norris's earlier novels had done well, but they never generated sufficient royalties to allow him to devote himself full time to writing.

Financial markets became an acceptable literary topic in the late 19th century, as those markets became more prominent and began to affect the lives of those who were not actively engaged in market activities. Author Peter Knight argues that, "From the 1880s onward…numerous novels, [and] short stories… were less immediately concerned with attacking the stock market than making sense of it, rendering its mechanism and patterns legible for their readers."

How Norris hit on the idea of a wheat trilogy is not known. One of his first mentions of it was in a March 1899 letter to William Dean Howells: "My Idea is to write three novels around the one subject of *Wheat*. First, a story of California (the producer); second, a story of Chicago (the distributor); third, a story of Europe (the consumer) and in each to keep to the idea of this huge Niagara of wheat rolling from West to East."

Once the idea was approved at Doubleday, Norris immediately went to California to research the first part of the trilogy. He spent a great deal of time researching his trilogy novels. For *The Octopus,* he went to California's wheat country to learn the ins and outs of farming, and he interviewed Collis P. Huntington, head of the Southern Pacific Railroad. Published in 1901, *The Octopus: A Story of California* chronicles the attempt of the fictional Pacific and Southwestern Railroad to force California wheat farmers off of railroad land they had occupied and improved hoping to eventually purchase their farms from the railroad. Although it wasn't a best seller, *The Octopus* sold better than any of Norris's previous novels. Once Norris finished *The Octopus*, he left California for Chicago to begin research for the second installment of the trilogy.

The Pit necessitated an extended stay in Chicago where his former Berkeley classmate, George Gibbs, tried to help Norris understand the intricate workings of the Chicago Board of Trade. Norris biographers Joseph R. McElrath, Jr. and Jesse S. Crissler wrote, "Not since he was a student of mathematics at Berkeley[2] did he find himself so intellectually challenged as he was when trying to comprehend the complex machinations of speculation in commodities like wheat."

Gibbs wrote, "While [Norris] was in Chicago securing the necessary information in regard to the book called *The Pit* I was with him constantly and he was unable to understand the short side of the market and how anybody could sell a thousand or a million bushels of wheat when he did not possess them. I tried in many ways to make this question clear to him, but it was many weeks before he could gain the right conception of short selling[3] in the wheat market."

However, an unconfident Norris, who moved to New York after completing his research in Chicago, continued to glean information from Edwin Lefevre, who's recently published *Wall Street Stories* touched on the kinds of market speculation Norris wanted to write about. Business journalist George Moulson also helped Norris with the technical aspects of the novel. According to Moulson, Norris "…had spent days watching brokers in the Chicago pit, he was a writer and understood very little about the speculative end of markets." Moulson reviewed chapter after chapter, helping with the technical details. He recalled how vividly Norris, "…portrayed the scenes, endowing my matter of fact, technical information with life and soul and how rapidly and fluidly the various chapters were composed during the intervals between our sessions. This went on for several months. He revised each chapter after our evening talks, so that the progress was consistent and timed to coincide with the progress of the marketing season. His grasp of the whole subject was amazing, and no effort was spared on his part in securing such thorough familiarity with a broker's psychology as would make his characters true to life." Norris so appreciated Moulson's help that he thanked him in *The Pit's* Preface.[4]

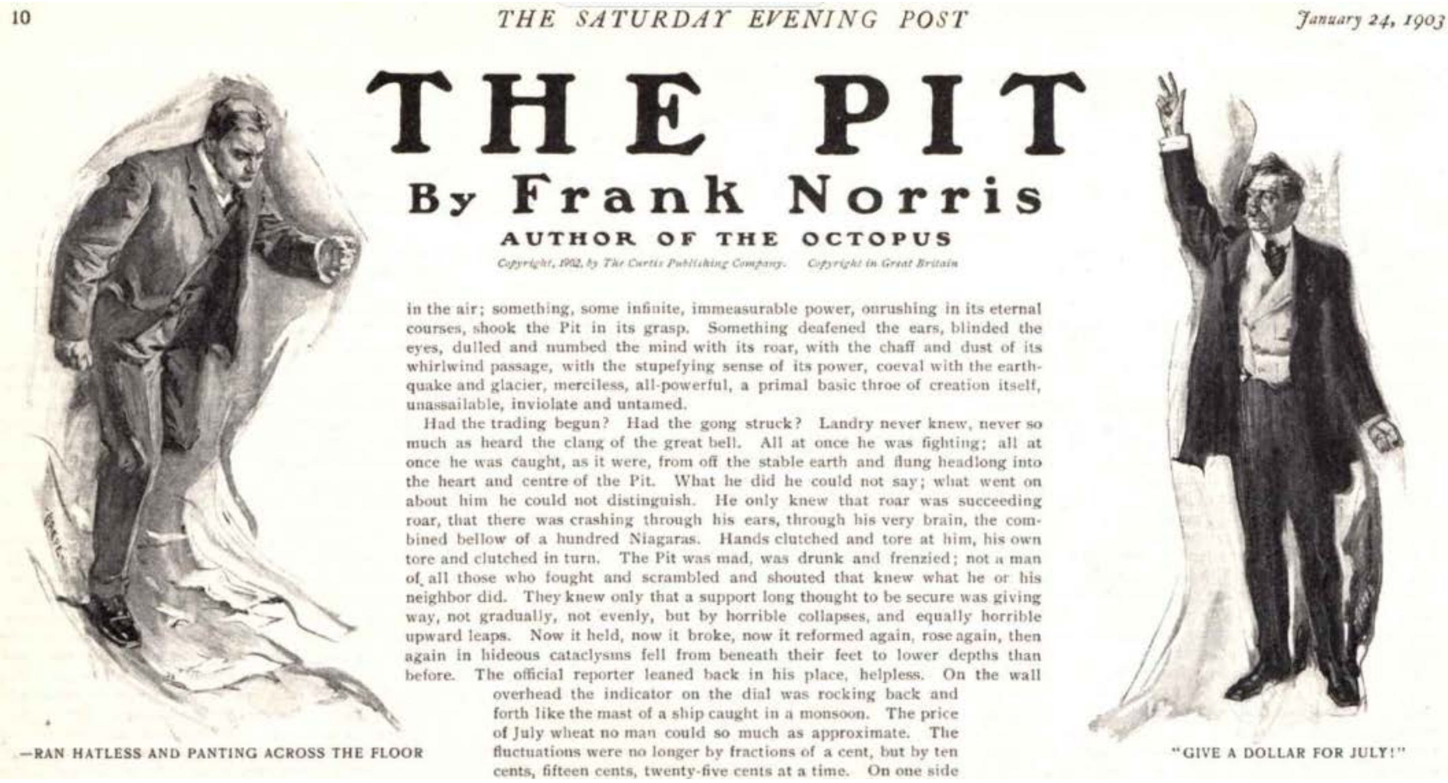
Often Jadwin had noted the scene, and, unimaginative though he was, had long since conceived the notion of some great, some resistless force within the Board of Trade Building that held the tide of the streets within its grip, alternately drawing it in and throwing it forth. Within there, a great whirlpool, a pit of roaring waters spun and thundered, sucking in the life tides of the city, sucking them in as into the mouth of some tremendous cloaca, the maw of some colossal sewer; then vomiting them forth again, spewing them up and out, only to catch them in the return eddy and suck them in afresh.

Thus it went, day after day. Endlessly, ceaselessly the Pit, enormous, thundering, sucked in and spewed out, sending the swirl of its mighty central eddy far out through the city's channels. Terrible at the centre, it was, at the circumference, gentle, insidious and persuasive, the send of the flowing so mild, that to embark upon it, yielding to the influence, was a pleasure that seemed all devoid of risk. But the circumference was not bounded by the city. All through the Northwest, all through the central world of the Wheat the set and whirl of that innermost Pit made itself felt; and it spread and spread and spread till grain in the elevators of Western Iowa moved and stirred and answered to its centripetal force, and men upon the streets of New York felt the mysterious tugging of its undertow engage their feet, embrace their bodies, overwhelm them, and carry them bewildered and unresisting back and downwards to the Pit itself.

— Frank Norris

Norris based his tale on an actual attempt to corner wheat that was still fresh in everyone's mind. Joseph Leiter, a wealthy Chicagoan, was only 29 in 1897 when he attempted to corner the international wheat market. According to his obituary, he "…lost $10,000,000 of his father's money."[5] Leiter saw that a combination of a weak wheat harvest and the rising threat of war with Spain would produce ideal conditions for cornering wheat. He began buying wheat futures contracts when wheat was selling at $0.73 per bushel and eventually drove the price up to $1.85. The corner eventually failed because Leiter tried to hold on to it too long, even after it was clear that a bumper wheat crop was in the making. Philip Armour, who had been bearish on wheat, battled Leiter's corner, and he worked with Leiter's father to stabilize the market after the corner failed.

In Norris's account, Curtis Jadwin, a successful Chicago real estate mogul, is lured into the wheat market by his broker, who offers Jadwin a piece of a sure-deal short in wheat. Jadwin resists at first saying, "…I had sort of made up my mind to keep out of speculation… A man gets into this game, and into it and into it, and before you know he can't pull out—and he don't want to." His broker, Sam Gretry, prevails upon him telling Jadwin, "…this ain't speculation. You can see for yourself how sure it is." Jadwin gives in and sells a million bushels of wheat short. He makes money on the deal, but, as he feared, he becomes hooked on wheat speculation. Jadwin continues to be bearish for quite some time, but when he realizes that the price of wheat will soon bottom out, he changes strategies. "Sam," says Jadwin to his broker, "the time is come for a great



10 THE SATURDAY EVENING POST January 24, 1903

THE PIT

By Frank Norris

AUTHOR OF THE OCTOPUS

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in the air; something, some infinite, immeasurable power, onrushing in its eternal courses, shook the Pit in its grasp. Something deafened the ears, blinded the eyes, dulled and numbed the mind with its roar, with the chaff and dust of its whirlwind passage, with the stupefying sense of its power, coeval with the earthquake and glacier, merciless, all-powerful, a primal basic throe of creation itself, unassailable, inviolate and untamed.

Had the trading begun? Had the gong struck? Landry never knew, never so much as heard the clang of the great bell. All at once he was fighting; all at once he was caught, as it were, from off the stable earth and flung headlong into the heart and centre of the Pit. What he did he could not say; what went on about him he could not distinguish. He only knew that roar was succeeding roar, that there was crashing through his ears, through his very brain, the combined bellow of a hundred Niagaras. Hands clutched and tore at him, his own tore and clutched in turn. The Pit was mad, was drunk and frenzied; not a man of all those who fought and scrambled and shouted that knew what he or his neighbor did. They knew only that a support long thought to be secure was giving way, not gradually, not evenly, but by horrible collapses, and equally horrible upward leaps. Now it held, now it broke, now it reformed again, rose again, then again in hideous cataclysms fell from beneath their feet to lower depths than before. The official reporter leaned back in his place, helpless. On the wall overhead the indicator on the dial was rocking back and forth like the mast of a ship caught in a monsoon. The price of July wheat no man could so much as approximate. The fluctuations were no longer by fractions of a cent, but by ten cents, fifteen cents, twenty-five cents at a time. On one side

—RAN HATLESS AND PANTING ACROSS THE FLOOR

"GIVE A DOLLAR FOR JULY!"

The Pit, as it appeared in the January 24, 1903 edition of *The Saturday Evening Post.*

big change," and he instructs Gretry to begin buying wheat contracts. Eventually, as wheat conditions worsen, Jadwin, realizing a corner is possible, begins his epic battle with the bears led by Calvin Crooke.

As the battle intensifies and Jadwin becomes more obsessed with his corner[6], he begins to lose a grip on reality. He neglects his wife and spends most of his time at his office planning his next move. When his wife asks him to take an evening off and go to the theatre with her, he retorts, "You think I am willfully doing this! You don't know, you haven't a guess. I corner the wheat! Great heavens, it is the wheat that has cornered me! The corner made itself. I happened to stand between two sets of circumstances, and they made me do what I've done. I couldn't get out of it now, with all the good will in the world. Go to the theatre to-night with you and the Cresslers? Why, old girl, you might as well ask me to go to Jericho." Clearly, the corner is beginning to weigh on Jadwin, but he continues to believe he has the situation under control.

Recalling his initial entry into speculation, Jadwin remembers his suspicions and fear. "Now," wrote Norris, "he had discovered that there were in him powers, capabilities, and a breadth of grasp hitherto unsuspected. He could control the Chicago wheat market; and the man who could do that might well call himself 'great,' without presumption. He knew that he over-topped them all—Gretry, the Crookes gang, the arrogant, sneering Bears, all the men of the world of the Board of Trade. He was stronger, bigger, shrewder than them all."

In this foolish state of arrogance, Jadwin believes he can hold his corner even in the face of bumper wheat crops, but his corner fails spectacularly, leaving him destitute and mentally unhinged. As a deluge of wheat hits the market, Jadwin's corner comes crashing down. In a final act of desperation, he rushes into the pit himself, as if his mere presence can stem the inevitable. As the floor traders cheer Jadwin's demise, Crooke, the bear leader, is heard to say, "They can cheer now, all they want. They didn't do it. It was the wheat itself that beat him; no combination of men could have done it—go on, cheer, you damn fools! He was a bigger man than the best of us."

In the next edition of *Financial History*, we will explore timeless concepts in *The Pit* that make it a relevant read today. We will also examine Norris's life and death, his attitude towards women and his anti-Semitic remarks that have caused him to fall out of favor today. $

Brian Grinder is a professor at Eastern Washington University and a member of Financial History*'s editorial board. Dr. Dan Cooper is the president of Active Learning Technologies.*

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Notes

1. The film can be viewed at https://www.loc.gov/item/2012600307/?
2. Norris wasn't able to graduate from Berkeley because he couldn't pass the required mathematics course. In a tribute to Norris, one of the professors who failed him wrote, "There was very little about algebra that attracted him. He was a keen observer of men and women as he saw them and interpreted their lives—their longings, their foibles, their loves, their truthfulness and their shams. It was thus he became a mirror showing us to ourselves."
3. According to Hull, "A *futures contract* is an agreement to buy or sell an asset at a certain time in the future for a certain price … The investor … who has agreed to buy [the asset] has what is termed a long *futures position;* the investor … who has agreed to sell [the asset] has what is termed a *short futures position.*"
4. In the Preface, Norris wrote, "The author's most sincere thanks for assistance rendered in the preparation of the following novel are due to Mr. G.D. Moulson of New York, whose unwearied patience and untiring kindness helped him to better understand the technical difficulties of a very complicated subject."
5. His father Levi Leiter, according to CBOT historian Emily Lambert, was a business partner with Marshall Field whose department store in Chicago made both men very wealthy.
6. Norris wrote: "By now his mind was upon this one great fact—May Wheat—continually. It was with him the instant he woke in the morning. It kept him company during his hasty breakfast; in the rhythm of his horses' hoofs, as the team carried him down town he heard, 'Wheat—wheat—wheat, wheat—wheat—wheat.' No sooner did he enter La Salle Street, than the roar of traffic came to his ears as the roar of the torrent of wheat which drove through Chicago from the Western farms to the mills and bakeshops of Europe. There at the foot of the street the torrent swirled once upon itself, forty million strong, in the eddy which he told himself he mastered. The afternoon waned, night came on. The day's business was to be gone over; the morrow's campaign was to be planned; little, unexpected side issues, a score of them, a hundred of them, cropped out from hour to hour; new decisions had to be taken each minute. At dinner time he left the office, and his horses carried him home again, while again their hoofs upon the asphalt beat out unceasingly the monotone of the one refrain, 'Wheat—wheat—wheat, wheat—wheat—wheat.' At dinner table he could not eat. Between each course he found himself going over the day's work, testing it, questioning himself, 'Was this rightly done?'"

Financial Discrimination and Innovation

Smith Collection/Gado

A group of African Americans outside the Holmes County Bank & Trust Co. in Lexington, Mississippi, October 1939.

By Robert E. Wright

One need not invoke Freud's injunction *homo homini lupus* (man is wolf to man) to understand the root of the American financial system's long history of exclusion and discrimination. Adverse selection and moral hazard stalk financial contracts more ferociously than any pack of depraved human wolves of Wall Street ever could. Most financial markets clear on quantity, not price, because those willing to bleed big to secure a loan or insurance policy often default or file claims. Unlike most businesses, therefore, financial institutions cannot serve all comers, or even the highest bidders. Instead, they must screen, monitor and ration. They have to say "no" to their most eager applicants if they wish to stay in business for long.

Disappointing applicants is therefore the nature of the financial beast. Little wonder, then, that Americans since the colonial period have continuously complained about being locked out of banks, insurers and other parts of the financial system. Most rejections were rational, the necessary consequence of asymmetric information: adverse selection and moral hazard. Many instances of exclusion and discrimination, however, were rooted not in prudent banking and insurance practices but in bigotry and irrational stereotypes with which admirers of the financial system cannot abide. After all, financial markets and institutions are necessary causes of economic growth, of sustained increases in inflation-adjusted output per person. Just as America and all the world's high-income nations prospered only after the creation of modern financial systems (and the governments to protect the human and property rights on which such systems thrive), so too individuals can thrive economically only when they have access to banks, brokers and insurers. To deliberately exclude creditworthy individuals from the myriad benefits of the financial system is tantamount to imprisoning them in poverty, and it renders everyone a little poorer.

Unsurprisingly, in the early national and antebellum periods, chattel slaves could not lawfully own bank notes or deposits, let alone shares in corporations. Married women were similarly excluded, unless they asserted *feme sole* status or contracted to hold an estate separate from that of their husbands. Free Blacks and single women were not legally excluded from the financial system, and some did obtain mortgages and make appearances in bank and insurance ledgers and corporate stockholder lists. Many, however, suffered financial exclusion. Contemporaries considered a gentleman creditworthy until he proved himself a knave, but a free Black woman was considered an unacceptable risk until she proved otherwise, which was no mean feat. Even pawn shops were leery of doing business with free Blacks, on the suspicion that the property they offered for pawn was stolen.

Passage of the 13th Amendment and married women property laws reduced legal exclusion from the financial system, but Jim Crow segregation laws and custom often kept women, Blacks, American Indians, immigrants and poor Whites on the fringes of finance. They did not remain passive victims, however, but

Library of Congress

Irish depositors of the Emigrant Savings Bank in New York City withdrawing money to send to their suffering relatives in the old country, March 13, 1880.

rather struggled to improve their access to business loans, mortgages, insurance and investment vehicles like mutual savings banks. They did it the traditional American way, called self-help. In other words, when they found themselves unreasonably excluded from incumbent financial institutions, they formed their own and got down to business.

In fact, the history of financial innovation in the United States can be told as the story of groups excluded from incumbent institutions creating their own markets and intermediaries. When British authorities told Philadelphia merchants Thomas Willing and Robert Morris that they could not form a commercial bank to alleviate the severe shortage of money and credit afflicting the colonial economy in the 1760s, they both joined a revolutionary movement that overthrew those authorities and established the Bank of North America, the new nation's first incorporated joint-stock commercial bank. When artisans, farmers, mechanics and retailers found that that bank, and its emulators, lent more freely to merchants than to them, they chartered their own commercial banks. So, too, did Irish, German and other immigrants when they believed they were not getting a fair shake.

Early commercial banks lent to businesses and did not seek, or even want, deposits from individuals. Their business model excluded the poor, who joined forces with philanthropists to create mutual savings banks, an early type of mutual fund. For-profit savings banks also cropped up, as did building and loan associations, which, along with wealthy individuals and life insurers, supplied the bulk of mortgages to middle class homeowners and small proprietors for over a century.

The working poor and middling types also developed their own life and health insurance via non-profit fraternal associations. Their organizations proved so successful at minimizing adverse selection and moral hazard that by the late 19th century big life insurers began to cater to the poor as well, with small denomination industrial life insurance policies. After World War II, inexpensive group term life policies offered by employers as fringe benefits supplanted industrial insurance.

While savings banks accepted deposits from the poor, they would not lend to them, leaving low-income individuals exposed to the predatory practices of pawn brokers and other chattel lenders, note shavers/loan sharks and salary buyers/payday lenders. Credit unions, industrial banks, loan societies and lombards arose to lend small sums for short terms to low income borrowers on easier terms. Despite the nominally high interest rates they charged, however, lenders generally did not find the market a lucrative one, so sharks still lurked, especially where usury laws limited lawful competition, as they long did in economically backwards places like Arkansas.

Financial regulations, like interest rate caps, often did more to hurt downtrodden groups than to help them. Bankers, brokers and insurers found loopholes in almost every law that tried to coerce them into behaving in ways that they believed were not in their best interest. Rather than fruitlessly try to force financiers to lend to members of groups that believed they were being discriminated against, regulators long encouraged self-help instead. Instead of telling incumbent life insurers to insure the lives of German immigrants, for example, New York policymakers allowed Germans to form their own insurers, like the Germania, which today is a Fortune 500 Company called Guardian Life Insurance Company of America. Similarly, Irish immigrants formed mutual savings banks, like the Emigrant Savings Bank, which served Irish immigrants for generations before demutualizing in 1986. At the other end of the financial spectrum, Jewish immigrants excluded from WASP-y social and business circles formed investment banks like Lehman Brothers and Goldman Sachs.

After the Civil War, African Americans who did not want to pay the high premiums demanded by incumbents on the basis of biased actuarial tables formed their own life insurers. The most efficient of them earned fortunes and in the process helped thousands of Black families to insure against the death of their breadwinners. Insurers like North Carolina Mutual proved so successful that white-controlled insurers realized that Black lives really do matter and began to buy Black-owned insurers, like Standard Life Insurance Company of Atlanta, or to court African Americans directly with more reasonable rates. By the 1960s, holding income constant, African Americans were more likely to have life insurance coverage than Whites.

Black-owned banks began to crop up in the early 20th century. Most eventually merged or failed, as did most White-owned banks formed in that era, but during their existence they helped Black families to finance their businesses, educations, homes and consumer durable purchases. According to Andrew F. Brimmer, a distinguished African American economist and member of the Federal Reserve's Board of Governors from 1966 until 1974, Black-owned banks faced higher costs than other banks. Higher costs reduced their profitability and increased their fragility, but also partially explained why incumbents had often charged Black borrowers higher rates.

In the 1960s, several brokerages and an investment bank owned by African Americans appeared on Wall Street. Before that, only a few African Americans had appeared in the nation's financial capital and they bore racialized nicknames like the Dark Prince (Jeremiah Hamilton) and the Black Wolf (H.R. George). In 1970, a young financial journalist named Myron Kandel (Board member of the Museum of American Finance) helped Daniels & Bell to raise sufficient capital to join the New York Stock Exchange (NYSE). Most Black investment banks and brokerages, like H.L. Wright & Company, failed or were acquired by White-owned firms, but not before providing valuable services to clients and stirring incumbents to hire more African American brokers and establish branches in places like Harlem.

About the same time, female brokers began to appear and a few, like Muriel Siebert, even bought seats on the NYSE. Urged on by legendary corporate gadfly Wilma Soss, female investors long outnumbered their male counterparts, though they owned fewer shares than men did, on average. Nevertheless, in the second half of the 20th century women proved a potent economic force, and incumbents increasingly catered to them.

Women had been bank borrowers and stockholders since the late 18th century, but not until the late 19th century did a few begin to take leadership positions in a handful of small institutions. In the early 20th century, many led special women's departments established by large commercial banks finally eager to attract their deposits away from building and loans, mutual savings banks and credit unions. Some of those women were able to leverage that experience into general supervisory roles and eventually a few, like Mary Vail Andress and Mary Roebling, made it into top management. The situation was similar in insurance. Top female financial executives, like Deanna Mulligan, the CEO of Guardian Life Insurance Company of America since 2011, remain too few.

Lyn Alweis

Mary Roebling, pictured here in 1980, was the first woman to serve as president of a major US bank and one of the few women to achieve a top management position in banking in the 20th century.

While the Women's Bank soon faltered, female-led brokerages and investment funds have thrived. Wall Street's super masculine culture, which at its nadir led to misogynist practices like those of the infamous "Boom Boom" room, created strong incentives for female financiers to strike off on their own. Important examples include Garzarelli Capital, the eponymous vehicle of NYU Ph.D. and 1987 stock market crash predictor Elaine Garzarelli, and Amy Domini's widely emulated Social Equity Fund. Today, Sallie Krawcheck's Ellevest invests with women's longer lives and lower incomes in mind.

Historians continue to unearth fascinating examples of financial self-help pioneers, especially individuals like Minnie Geddings Cox, who lived at the intersection of race, class and gender. Born to former slaves in Mississippi in 1869, Cox graduated from Nashville's Fisk University before opening the Delta Penny Savings Bank and the Mississippi Beneficial Life Insurance Company early in the 20th century.

American Indian and poor White financiers, however, remain conspicuously absent from these new narratives, but for different reasons. Only recently have scholars begun to explore in earnest the history of poor Americans of Euroamerican descent who lurk in historical sources, uncounted but in plain view, under scores of derogatory nicknames. Physically, poor Whites can easily "pass" as members of the middle or upper classes, but their language, behaviors and clothes often give them away.

For readers who doubt that poor Whites faced significant discrimination, consider the following, which was uttered in Indianapolis in 1956 about poor White emigrants from southern Appalachia:

> These people are creating terrible problems in our cities. They can't or won't hold a job, they flout the law constantly and neglect their children, they drink too much and their moral standards would shame an alley cat.

To this day, poor Whites are often shunted into their own "ghettos," composed of substandard houses, euphemistically called "mobile homes" and arranged in tightly-packed "trailer parks," ineligible for standard mortgages and subject to the whims of predatory landlords.

But the discrimination they face pales in comparison to that inflicted upon American Indians. Enslaved, murdered, forced

Keystone / Stringer

Customers wait in line at the Dunbar National Bank in Harlem, New York, January 7, 1933. The bank was owned by African Americans and served the local Black community.

out of their homelands, cheated out of their new lands, subjected to the socialist policies of the Bureau of Indian Affairs (BIA) and regularly called derisive names, Indians nevertheless persevered and even prospered, until the bases of their prosperity (grazing lands, mineral rights, casinos, tax exemptions) were ripped from them anew. Amerindian scholars like Robert Miller and Dean Chavers have shown that Indians are people too, not stoic environmentalists happy to live in squalor. Rampant alcoholism, diabetes and suicide stem from desperation, not Indian culture, which was highly entrepreneurial before the long chain of tragedy unleashed by the arrival of Columbus in the New World destroyed Indians' incentives to work hard or smart. Contrary to myth, many pre-contact Indians engaged in manufacturing as well as agriculture and were avid traders with complex monetary systems only now being partially reconstructed from archaeological and anthropological records too long ignored or misinterpreted.

Indians, too, have engaged in financial self-help. South Dakota's Lakota Fund is perhaps the most famous of the few dozen NCDFIs (native community development financial institutions) that have recently appeared. While they have helped some Indian entrepreneurs, many Indians remain desperately poor and will remain so until the BIA stops infantilizing them with its paternalistic policies, significant land tenure reform is undertaken and bigotry declines. Just 20 years ago, a white South Dakotan actually issued a faux license to hunt and trap Indians.

The plight of American Indians reminds us that while finance can empower individuals and spark economic growth, it cannot overcome systemic stereotyping based on race, class or gender, a lesson that the US government seems to have forgotten in the 1990s and that all Americans paid for during the 2007–9 financial crisis. The story is a long, complex one, but it boils down to the fact that regulators believed that discrimination in mortgage markets could be eliminated by both forcing and enticing lenders to ignore asymmetric information and lend willy-nilly, virtually to all comers regardless of their assets, income or credit history. Fancy new derivatives, which turned out to be neither novel nor all that sophisticated, were purported to render such dodgy loans perfectly safe. Hearts thumped while home prices and home ownership rates ticked upward, drowning out the cries of reasoning minds.

Easy credit policies and the resulting crash also spurred a wave of financial predation (deliberately lending to vulnerable borrowers to seize their collateral) unparalleled in its ferocity. Had regulators continued to promote financial self-help, a few small institutions certainly would have failed, but financial predation would have been kept in check and the global financial system would not have been endangered. Today's zeitgeist points toward another potential catastrophe, direct government lending. Although some colonial loan offices succeeded, most government lending direct to individuals turned out badly. Politicians used the promise of loans, then of loan forgiveness or forbearance, to buy votes, practices that many found difficult to reconcile with democracy.

Financial exclusion, discrimination and predation make us all poorer by keeping deserving, creditworthy individuals trapped in poverty instead of unleashing their full potential as consumers, entrepreneurs and workers. Government, however, cannot end such practices by fiat. The best it can do is to encourage those who feel discriminated against to innovate and form their own financial institutions and markets. $

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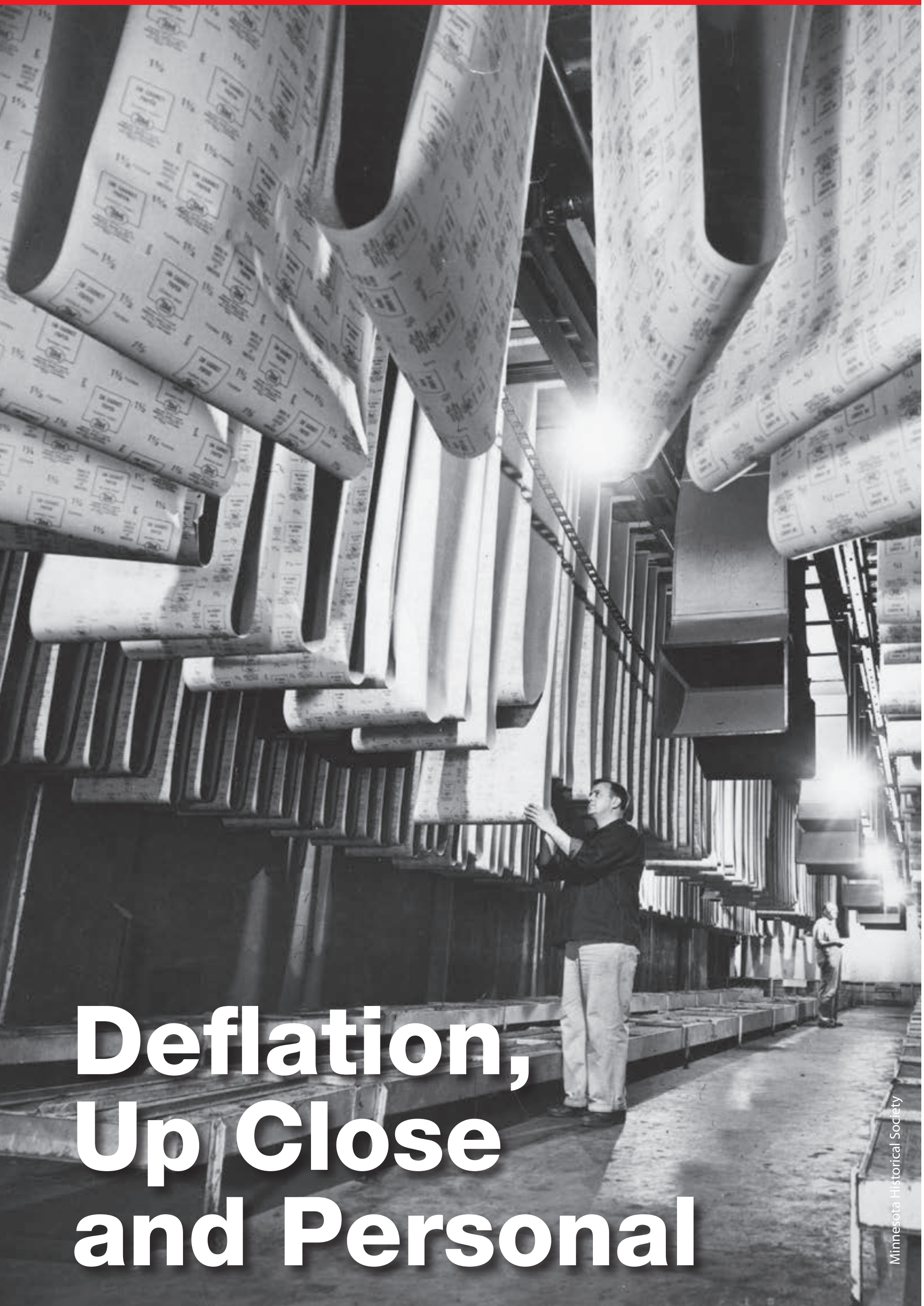

Minnesota Historical Society

Deflation, Up Close and Personal

How 3M Conquered the Depression of 1921

By Daniel C. Munson

Most readers of economic and financial history have digested and interpreted the many big financial events of the 20th century: The Great Depression, the war mobilizations, the oil shocks and inflations, etc. These economic events demanded attention and interpretation not only because of their severity, but also their duration. The Great Depression, for example, is often thought to have begun with the stock market crash of October 1929, but its effects lingered into the late 1930s.

The economic record of the tumultuous 20th century contains other interesting but largely ignored or undigested events. This may be due to their brevity. The stock market crash of October 1987, for example, a much sharper decline than that of October 1929, is now largely ignored by all but historians of stock market technical detail, perhaps because prices quickly recovered and the crash had little long-term effect on the nation's economic life.

One of the most startling of these undigested events, the details of which are simply mystifying to us today, is the quick and sharp depression and deflation of 1920-1921. Inflation, not deflation, has been the constant in monetary affairs over the last century, one during which increasing prices of goods and services became relentlessly commonplace.

The 1921 deflation/depression is hard to ignore from the economic data. A scan of some of the nation's most studied economic measurements reveals only two real bouts of deflation in the last 100 years. The most famous of these, the Great Depression and the dreadful economic year of 1932 that saw the consumer price index decline by 10.3%, has been studied to death. The drop in prices in 1932 did not set a calendar year record, however. The calendar-year deflation record is held by 1921, when consumer prices declined by 10.9%. Monetary historians Milton Friedman and Anna Jacobson Schwartz could not ignore the 1920–1921 slump: they called the 1920–1921 deflation "unprecedented," the related drop in economic activity "one of the most rapid declines on record."

Manufacturing sandpaper at the 3M plant.

1921? The beginning of the Roaring Twenties? What could have happened to cause such a drop? And what has allowed so many of us to ignore those 1921 events?

The answer to that last question, hinted at earlier, is that the downturn in prices and economic activity in 1921 was sharp but brief—very brief by modern standards. Given that such downturns occur with frustrating regularity, a look back at the details surrounding the 1921 deflation/depression might be instructive.

Let us then focus on the year 1921, and let us not confine ourselves to platitudinous, macroeconomic generalities devoid of detail. Let us consider, instead, "all things both great and small."

The Minnesota Mining and Manufacturing Company, now known the world over as 3M, was a small, fledgling sandpaper maker in 1921. The company name was a little presumptuous: there were plenty of other, larger mining and manufacturing concerns in the state (although few did both), and sandpaper was not the most important of manufactured goods. The process for making sandpaper, however—straining rock granules of a required hardness by diameter, sprinkling them onto a soft base coating, then sizing, drying and curing—was the sort of process that might be extended to the production of other products.

The 3M we know today as an American industrial behemoth, a mainstay of the Dow Jones Industrial Average, had been an even smaller, money-losing outfit when World War I began in 1914. The onset of war didn't help matters: the conflict caused great economic as well as political uncertainty, and stock markets around the world closed down for months for fear of panic selling. After the initial shots were fired, however, and the belligerents put their economies on a war footing, it became clear that demand for industrial goods of all kinds would increase, and that inflation of the currencies of the warring countries would result. The United States did not initially join the fray, but American prices drifted upward along with those of the warring countries.

Inflation is the industrialist's best friend, at least when it is just beginning or kept from spiraling out of control. Raw material inventory acquired at low prices is gradually transformed into final product that can be sold months later at higher prices due to the general increase in all prices that characterizes a currency inflation. Operating margins almost can't help but improve.

Little 3M would benefit mightily from this combination of war spending and inflation. Its sales totaled a mere $263,000 in 1914, and its expenses easily exceeded that figure. By August 1916, however, the company president could tell the Board that, "Business has more than doubled in the last two years," adding "we'll have enough left over to pay a dividend."

Sandpaper was perhaps a prosaic item, but because it was used in automobile production and repair, it was in high demand nonetheless. American-made military vehicles were being shipped to Europe even before America entered the war, and civilian automobile sales grew by leaps and bounds following the armistice in November 1918. Automobile production doubled in 1919 from 1918 levels. This growth in the automobile business combined with the war-induced inflation to cause 3M company sales for 1919 to ring in at $1.4 million, a figure exceeding expenses by a whopping $440,000. Profits in 1919 were greater than total sales only five years before.

It was as the 3M accounting department was tallying up these surprising figures that economic conditions began to turn. The culprit behind the turn was interest rates. The Federal Reserve Bank, looking to curb inflation-fueled borrowing, increased the lending rate it charged its member banks from 4.75% to 6% on January 21, 1920, and from there to an almost punitive 7% rate on June 1.

This set the stage for a massive deleveraging. Banks sought to cut back their lending in order to reduce their high-interest borrowing, and the rout was on. Automobile sales, then as now dependent on financing, dropped like a rock. From levels of roughly 50,000 per month in early 1920, sales of General Motors vehicles declined to 13,000 by November, and to less than 6,200 in January 1921. General Motors continued to ramp up production until the end of the year, however, which left it with a mountain of inventory, finished and unfinished, when production was finally curtailed in late 1920.

The effect on a small, automobile-oriented enterprise like Minnesota Mining and Manufacturing was huge. As auto sales dropped, demand for their product sagged. The beneficial effect that the general inflation of 1914–1919 had on company margins now began running in reverse. Inventory generated at boom prices had to be marked down significantly in order for it to move at all, and the downward effect on revenue and margins was thus compounded. Company leaders must have looked at the situation and wondered if the inflation-aided prosperity of 1919 would be the high-water mark of company fortunes.

By the early months of 1921, things had reached a critical juncture. With demand dwindling for a product that was declining in price, company management faced a stark choice: reduce workers or reduce wages. Sandpaper production had increased markedly in the years leading up to the break, and it was clear that the skills their work force had developed were responsible for this improved productivity. It didn't seem the brightest idea to lay off a work force that had developed such skills.

The choice was made easier by the simple realization that prices of other goods, the various necessities of life, were also falling through the floor. Crop prices had declined by more than half in the last six months of 1920, and grocery prices followed. One dramatic example, made worse by inflation-fueled lending to Cuban sugar planters, was the price of sugar: from a per pound high of 22 cents in early 1920, sugar prices declined by over 90%, to two cents in 1921.

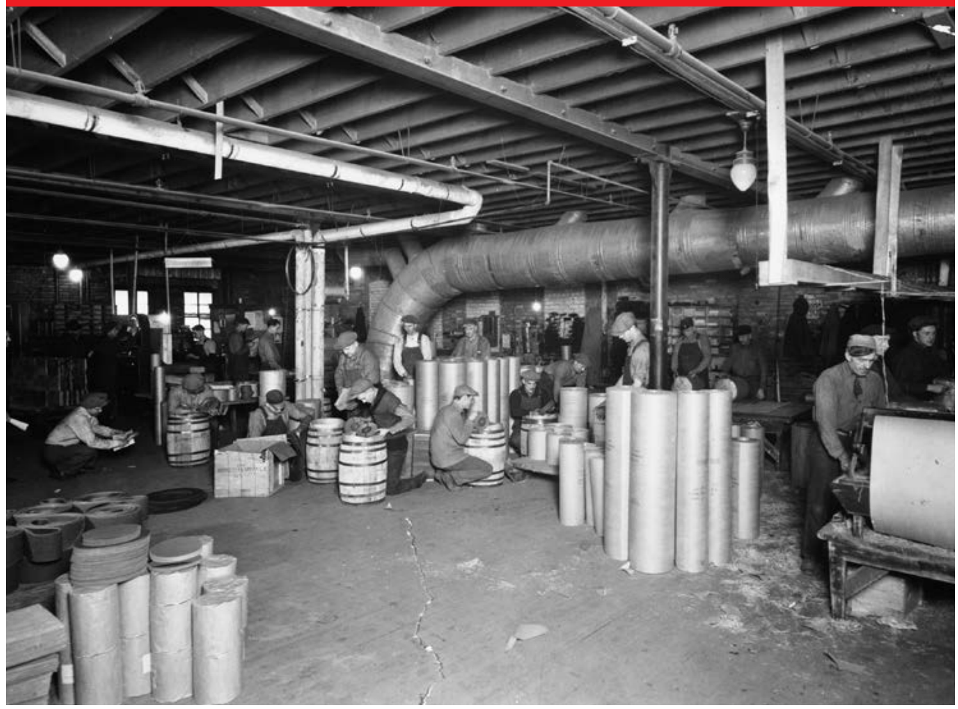
Incoming President Warren Harding acknowledged the rout. In his inaugural speech on March 4, 1921, he commiserated with the nation's workers and businessmen. "Our people must give and take," he said, acknowledging the slings and arrows they had suffered. "Perhaps we shall never know the old level of wages again," he speculated, concluding that, "We must face a condition of grim reality, charge off our losses and start afresh. It is the oldest lesson of civilization."

The management of Minnesota Mining spelled out the decision they made later that month in company bulletins #71 and #72. "Owing to a change of business conditions," the bulletins announced, hourly pay would have to be cut across all pay grades. Such grades were arranged

by gender and years of service, with the women who did much of the office work earning less than the men who worked the production lines. From levels of 52–57 cents per hour (approximately $25–30 per hour today), the men saw their pay sliced by 7.5 cents per hour across all pay grades —a stunning 14.3% cut for the lowest pay grade. From levels of 29–34 cents per hour, pay for women was cut by three cents—a slightly lower percentage—from this lower pay rate. The decline in company and worker outlook in just 15 short months must have been sobering.

These financial difficulties were occurring just as the company was preparing to introduce its first new and improved product. Company leaders had been working with an inventor in Pennsylvania named Francis Okie, who had sent them an odd letter many months before expressing interest in buying samples of their granules. Subsequent conversations revealed that Okie had developed a waterproof coating to anchor the granules. Sandpaper manufacturers near Okie in Pennsylvania were willing to allow him to use their production lines to make small experimental runs, but they refused to sell him large quantities of their granules to expand his production. Okie wrote the only other sandpaper manufacturer he could identify, little 3M Company way out west in St. Paul.

3M employees knew well that use of the company's sandpaper sent dust airborne, dust that was hardly a salutary addition to the workplace. A waterproof sandpaper held out the possibility of sanding in water, which would allow users to wash away the dust rather than sending it into the air. They immediately agreed to work with Okie, and Okie sent five-gallon pails of his chemical coating from Pennsylvania to St. Paul. Batch quality varied in a matter that frustrated all involved, and Okie eventually moved to St. Paul to be closer to the production process. May 1921 saw the first sales of this new product—called WETORDRY™—to Maxwell (now Fiat Chrysler) and Buick Motors. Automobile makers and automobile body repairmen soon developed the technique of running water over the area being sanded—"wet sanding"—with WETORDRY sandpaper, which washed away the dust and prevented it from accumulating around the granules on the paper.


Minnesota Historical Society

The 3M shipping room in St. Paul, Minnesota, circa 1920.

The deflationary depression that clouded the introduction of WETORDRY, with all its distress and slashed wages, was sharp and sudden—and short. Interest rates were lowered and business activity bottomed in mid-year 1921, although consumer prices continued downward. Prices declined a little further in 1922, but GNP jumped 6.6% from 1921 levels, and the rebound in business activity trumped the decline in prices. Leveraged measurements of economic activity jumped even higher: The earnings of the Dow Industrial companies increased by over 300% in 1922 from the depressed levels of the year before, and the number of businesses reporting 1922 profits in excess of $100,000 increased 66% from their numbers in 1921.

One of those companies was Minnesota Mining and Manufacturing. Sales snapped back. The WETORDRY product helped bring the yearly sales total to over $2 million in 1923, with profits for the year greater than those inflation-fueled levels of 1919.

The 1920s would roar on. The 3M Company created a research laboratory in 1924, initially to monitor the quality of their new waterproof coating and sandpaper. The following year, their researchers branched out to develop and introduce masking tape, the first version of what the company later called Scotch™ tape, an adhesive in place of the base coating applied to a paper backing that permitted auto workers to quickly mask off and control paint areas to create "two-tone" automobiles. In 1930, they introduced a cellophane tape—popular now for gift wrapping (Magic™ tape)—by substituting a water-resistant film to support the adhesive, their first of thousands of consumer products. It was a tremendous decade of growth for the company: Minnesota Mining and Manufacturing increased sales over five-fold during the period 1921–1930, and by the end of the decade the company name wasn't quite so presumptuous.

These variations on the general method used to make the original sandpaper product were possible because the company weathered the financial storm that was 1920–1921. Faced with the financial difficulties of that wicked, seemingly bottomless depression and deflation, 3M had the flexibility to quickly adjust its labor expenses in line with demand and general prices.

The early months of the downturn that began eight years later, in 1929, were actually much less severe than the downturn

of 1920–1921. Prominent Yale economist Irving Fisher announced in May 1930 that, "thus far the difference between the present comparatively mild business recession and the severe depression of 1920–1921 is like that between a thunder-shower and a tornado." This time, the nation's leaders met the "mild business recession" with a very different response. Businesses fought to keep wage levels up for fear of reducing what was beginning to be called "aggregate demand."

The most prominent proponent of this effort was Henry Ford and his Ford Motor Company. Ford stubbornly raised workers' wages in 1930 to combat the decline. President Hoover announced in May 1930 that, "for the first time in the history of great slumps, we have had no substantial reduction in wages." Of those firms reporting their activity to the Bureau of Labor Statistics, 92% had reduced wages in 1921, while just 7% did so in 1930.

This stubborn approach to keep up wages and "aggregate demand" did not work. Other factors—the Smoot-Hawley tariff bill, income tax hikes, the repeal of dollar-gold convertibility—contributed to cause the mild recession described in May 1930 to deepen. 1931 would be one of the most difficult years of the 20th century, and by mid-year 1932, things had completely collapsed. Unemployment soared. The economic rout that was the 1930s was on, and the difficult days of 1920-1921 and the lessons that those events might hold began being erased from the nation's collective memory. $

Dan Munson is a student of financial and scientific history. His writings have appeared in Barron's Financial Weekly *and many other publications. He enjoys reading and writing financial and scientific history and worked for many years at 3M.*

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“A Commercial Emancipation” for the Negro

Financing Black Business in the 1920s

National Park Service

By Shennette Garrett-Scott

Maggie Lena Walker probably was no longer surprised that she was the lone woman among the 50 or so African American business, banking and insurance leaders attending a banquet in late 1924 in New York City. The banquet had been called "to stabilize, strengthen, and protect Negro business." As president of the St. Luke Bank and secretary-treasurer of the Independent Order of St. Luke (IOSL) in Richmond, Virginia, Walker stood as the most powerful Black woman in the financial industry. She had worked most of her life to prove that women could excel in the financial world, and her presence lent legitimacy to, if not full acknowledgment of, women's critical roles in the financial industry. She surely wondered whether her lifelong efforts counted for much, because here she was again: the only woman in a room full of Black men who were charting, as they imagined, the economic future of the race.

The select group of business leaders outlined plans for the National Negro Finance Corporation (NNFC), a million-dollar corporation that would launch Black business into a new financial age. Walker took advantage of the novelty of her presence. She offered the St. Luke Bank as a model to emulate for the young finance company. She told the austere group, "We shall not stop, but put our moneys and brains together and achieve a commercial emancipation." Walker echoed her call to IOSL members two decades earlier, when she had first shared her vision for a bank that was largely owned and run by women for women.

The NNFC shared ambitious goals with another Black-owned finance company launched in the early 1920s: the Allied Industrial Finance Corporation (AIFC). Bitter rivalries for control over the vision for the future of Black business, however, soon emerged between the two companies. The finance companies differed in their opinions about the role that capital and expertise from White investors should play. Black investors responded in complex ways to the heightened appeals of Black-owned finance companies to race pride, racial uplift and risk. Finally, internal difficulties undermined the finance companies and highlighted the difficulties in achieving a true economic emancipation for Black communities.

Studio portrait of Maggie Lena Walker, president of the St. Luke Bank and secretary-treasurer of the Independent Order of St. Luke (IOSL) in Richmond, Virginia.

Origins of the Allied Industrial and National Negro Finance Corporations

Both the AIFC and the NNFC companies grew out of the National Negro Business League (NNBL). Formed in 1900 by Booker T. Washington, the NNBL was the largest association of Black businesspeople and professionals in the country. Washington served as president of the NNBL until his death in 1915. For some years, even before Washington's death, Emmet J. Scott, Washington's personal secretary for nearly two decades and secretary of the NNBL, had longed to see the NNBL evolve. Scott imagined an organization that provided critical services to Black-owned businesses. Once out from under the long and formidable shadow of Washington, Scott attempted to shift the NNBL's center of gravity from Tuskegee, Alabama, to more cosmopolitan climes in Washington, DC or New York City. He also wanted to reconstitute the executive committee and leadership to tap into the dynamism of a younger generation of self-made men.

Stymied in his efforts to remake the NNBL, in late 1920 Scott organized the Allied Industrial Finance Corporation (AIFC) to provide capital to Black businesses. Initially, Scott planned to raise the majority of the $3.75 million of capital from leading White financiers such as the Rockefellers, Julius Rosenwald, George Foster Peabody and others who had been longtime financial supporters of the NNBL. Scott also dug into his deep contact list of Black business leaders to constitute the AIFC board. The AIFC made its headquarters in the sparkling new Southern Aid Building in Washington, DC.

Fearful that Scott's AIFC might actually succeed and best the NNBL, in early 1924 Charles C. Spaulding arranged a secret meeting in Durham with a select group of businessmen and then an open organizational meeting in early June. Spaulding, co-founder of the North Carolina Mutual Insurance Company and president of the Mechanics and Farmers Bank in Durham, was arguably the most well-known and respected Black businessman in the country. At the banquet in New York City in November, where Maggie Lena Walker had declared "a commercial emancipation," Spaulding officially announced the launch of the NNFC.

The goals of the NNFC were even more ambitious than the AIFC's. In addition to providing capital for new Black businesses, the NNFC wanted to maintain a corps of industry experts to advise business people. The NNFC planned to create a stock exchange that would sell stock in and securitize assets backed by Black businesses. The corporation's prospectus and publicity documents dangled the possibility that the NNFC would invest in non-Black-owned businesses but made clear that the NNFC, unlike the AIFC, would not court capital investment from White businessmen and philanthropists. The NNFC wanted to put Blacks' assets to work in the larger US financial market, blurring and perhaps even erasing the color line in high finance while compounding the assets of Black investors. Future plans included establishing a credit information clearinghouse, similar to Dun and Bradstreet, for Black businesses.

Competing for the Hearts and Minds of Black Investors

The organizers of both finance corporations also hoped to woo investors away from the charismatic Marcus Garvey, leader of the Universal Negro Improvement Association (UNIA) headquartered in Harlem, New York. Garvey's assertive calls for Black pride had helped him raise millions of dollars to support UNIA programs, ancillary businesses and development projects. In January 1920, Garvey organized the short-lived Negro Factories Corporation (NFC). Capitalized for $1 million, working-class Blacks gobbled up shares at $5 each. The NFC eventually operated a laundry, a millinery store, a small chain of grocery stores, a restaurant

Independent Order of St. Luke staff, with Maggie Walker pictured near the center.

and a publishing house. The NFC planned to open factories to manufacture clothing, toiletries, canned goods and other items. These factories would employ thousands of Black workers to produce goods for Black consumers in the United States and to ship goods overseas on the Black Star Line, the UNIA's shipping company. Garvey openly refused White investment capital in the NFC, boasting, "The world is looking to see what the New Negro will achieve in the field of commerce." He believed large-scale investment and finance by and among Blacks to be essential to the broader dream of racial uplift and self-help.

Garvey's message found support among some women members of the Black entrepreneurial elite. Both Maggie Lena Walker and beauty culture products mogul Madam C.J. Walker—reputed to be the first Black woman millionaire—admired Garvey. Garvey's photograph and his famous editorial, "African Fundamentalism," hung prominently in Maggie Lena Walker's parlor. Scholars consistently cite Booker T. Washington as a critical influence on Garvey, but Garvey also drew inspiration from female contemporaries such as Maggie Lena Walker. The IOSL's social activities and its business model; Walker's strong support of independent, black economic self-help; and her focus on the needs of working-class people represented foundational models for Garvey and the UNIA.

Both the AIFC and the NNFC hoped to siphon some of the largess from Garvey's coffers into their own and relied on appeals to manhood to buttress their efforts. Despite past clandestine efforts to secure assistance from White investors, both the NNFC and the AIFC advocated—at least publicly—self-help efforts that were independent of White assistance as a cornerstone of manly enterprise. The AIFC and the NNFC worked hard to win small, individual investors to raise their multimillion-dollar capital requirements.

Black business had long solicited and depended on Black investment dollars. Working- and middle-class Blacks responded to rhetoric that stressed stock purchase not merely for personal gain, but for racial uplift and collective prosperity. In the 1920s, links between race pride and manhood made full-throated endorsements of stock investment as a civic duty and a demonstration of citizenship. For example, the AIFC promoted investing as a "privilege and a right" and as an experiment in "Financial Democracy." The NNFC's prospectus also connected a desire for wealth with the desires of any true citizen, as stressed in a string of superlatives that deserves extended quotation:

> Every progressive, thrifty, red blooded, clear headed, liberty loving, property seeking American with grit in his craw and iron in his bones cherishes lofty

> and laudable ideas; among which are: to live a Christian life; to serve his fellowmen; to acquire sufficient wealth to gratify all normal desires; [and] to create eventually an estate for later years which shall inure to the benefit of those most immediately dear to him.

The prospectuses of both finance companies made explicit links between financial and civil responsibilities and rights.

The fact that neither the AIFC nor the NNFC traded its stock on an exchange represented a glaring barrier for Black investors and the companies seeking their dollars. The various stock exchanges barred Black businesses' participation. Thus, the AIFC and NNFC relied heavily on direct marketing to consumers and on personal and professional networks. To put the privilege and right in reach of their potential investors, the firms allowed buying on the margins like most other financial institutions in the period. Borrowers purchased stocks with borrowed money and on borrowed time.

Even if subscribers fulfilled their stock subscriptions, there was no guarantee that they would ever see the promised windfalls. Any investment represented a risk for loss. The NNFC, however, recklessly dismissed the financial risks. Its prospectus read, "There has never been a better opportunity or a better reason offered to members of the race for investment. Every safeguard has been thrown around the organization to protect and conserve the funds and insure the safety of the investment." The NNFC was hardly alone in promising great riches for a small investment and limited risk. It joined other "blue-sky promoters" who endorsed all kinds of money-making schemes. The promise of a commercial emancipation increased the appeal of stock investment but downplayed the associated risks of any speculation. Gambling on the race was no gamble at all, promoters enthused, but rather an informed, rational and selfless decision. Charged racial appeals combined with the practice of buying on the margins reflected the reckless overconfidence that made the 1920s roar.

Mismanagement and the inability to raise adequate capital spelled the demise of the AIFC in 1925. The NNFC followed closely behind. Stock subscriptions dried up, and stockholders demanded not just dividends, but a return of their capital investment. A 1927 financial statement showed assets of a little more than $4,100 cash on hand, three mortgage bonds totaling nearly $10,000, a bond for the Virginia Theological Seminary and College in Richmond (present-day Virginia Union University) and a few stocks in other Black businesses. By 1928, the NNFC ceased any pretense of operation.

Drawing of the officers of the National Negro Business League (NNBL). Formed in 1900 by Booker T. Washington, the NNBL was the largest association of Black businesspeople and professionals in the country.

The Allied Industrial Finance Corporation and the National Negro Finance Corporation failed to effect a commercial emancipation for the race. Rhetoric about manhood and citizenship resonated with Black investors, who invested for complex reasons. They were not dupes who fell for questionable schemes, but rather calculating and strategic economic actors trying to bend capitalism to their needs. Both ventures failed to raise sufficient capital to fund their ambitious schemes, but they should not be judged complete failures. They reveal the efforts of the Black financial industry to boldly tackle the limitations of racial segregation and the continued commitment to communal-focused approaches to economic development and wealth building. $

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A Note on Sources

Find news stories about the AIFC and NNFC in early- to mid-1920's newspapers, especially Black newspapers including the *Pittsburgh Courier*, *Chicago Defender*, *New York Age*, the UNIA's *Negro World* and the IOSL's *St. Luke Herald*. Some digitized AIFC papers held by the Amherst Libraries, University of Massachusetts are available online from Digital Commonwealth: Massachusetts Collections Online at https://www.digitalcommonwealth.org. A few remnants of the NNFC's papers can be found in the C.C. Spaulding Papers in the Rubenstein Library, Duke University, and in the Albon L. Holsey Papers and the Robert R. Moton Papers in Special Collections, Tuskegee University. On the NNBL's history, see John H. Burrows, *The Necessity of Myth: A History of the National Negro Business League, 1900-1945* (Hickory Hill Press, 1988) and Shennette Monique Garrett, "'He Ran His Business like a White Man': Race, Entrepreneurship, and the Early National Negro Business League in the New South" (M.A. Thesis, University of Texas at Austin, 2006). For sources on Marcus Garvey and the UNIA, see the 13-volume *The Marcus Garvey and Universal Negro Improvement Association Papers*, edited by Robert A. Hill and published by Duke University Press and *Marcus Garvey: Life and Lessons, a Centennial Companion to the Marcus Garvey and Universal Negro Improvement Association Papers*, edited by Robert A. Hill and Barbara Bair (University of California Press, 1987).

By Anne Fleming

"Of all the evils to which modern society has given birth, there is scarcely one more insidious, far reaching, and disastrous in its effects than the institution of the money lender or 'loan shark,' as he is more unpopularly known," a *Chicago Tribune* reporter proclaimed in 1908. The reporter lamented that high-rate moneylenders continued to plague the city and demand their "pound of flesh," despite a recently enacted law designed to "deal a vital blow" to the "whole nefarious business."

With or without legal sanction from the state, so-called loan sharks found plenty of willing "victims" among the "great army of wage earners" in the Windy City, who were "forever pressed by the need of money." Four years later, as the sharks continued to circle Chicago, another *Tribune* writer observed, "It is easy to condemn the loan shark evil but hard to correct it." The root of the problem was simple: "Men, now and then, must have money." The hard part was figuring out how to grant urban workers access to small amounts of credit at reasonable prices.

Over a century later, much has changed. The laws governing small loans have developed over time, both reflecting and spurring the ascendance of new ideas about the proper regulation of the business. The American economy has also changed dramatically, with the growth of industrial, clerical and service-sector work, along with the decline of agricultural employment. Meanwhile, the advent of mass production brought down the price of consumer goods and enabled mass consumption.

The demographic characteristics of those struggling to make ends meet, "forever

Kevin Horan

A check cashing store in Chicago offering cash advances, 1998.

CITY OF DEBTORS

A Century of Fringe Finance

pressed by the need of money," have varied over time as well. By some estimates, roughly 40% of the American population lived in or near poverty in the early 20th century but—over the last three decades—the official poverty rate has never exceeded 20%. Moreover, rising standards of living have improved the lot of all Americans, including low-income households. Families struggling to get by in the modern era may own televisions and other consumer goods that did not exist a century ago. But thanks to the growth of the mass media, these households have also become more keenly aware of their relative hardship as compared to those higher up on the income distribution.

Along the way, legal and economic change has helped kill off some forms of small-dollar credit and encouraged others to grow, eventually yielding our present-day "fringe lending" institutions, which include the payday lenders and rent-to-own stores that now cluster in low income neighborhoods and operate storefronts in cyberspace. The small-sum lending business has grown exponentially over the course of the past hundred years, from a marginal enterprise into a big business that generates over $10 billion in revenue each year. At last count, there were over 15,000 payday lender storefronts in the United States, and over 9,000 rent-to-own stores in the United States, Canada and Mexico.

Yet, the problem of high-rate, small-sum lending continues to trouble both policymakers and ordinary people. Americans remain divided over how to police the industry. Most acknowledge that working-class households "now and then, must have money," as the *Chicago Tribune* reporter observed over a century ago. Nonetheless, many worry about the high cost of small loans and fear that lenders are taking advantage of the most vulnerable households.

Policymakers and everyday Americans are perpetually torn between dueling desires, wanting to protect working-class debtors while also allowing them easy access to credit and control over their own financial lives. Both favorable and critical views of the business persist, in the celebration of microfinance as an engine of social mobility and the vilification of payday lending as a modern form of debt peonage.

For decades, little loans have troubled many Americans because they raise a big, vexing policy question: what is the meaning of justice within capitalism? Since the rise of the small-sum cash lending business in the 1890s, those on the lowest rungs of the economic ladder have been asked to pay the greatest cost for credit. Time and time again, Americans have puzzled over why the smallest loans to the most fragile borrowers seem to come with the biggest price tags.

The long struggle to regulate fringe finance began over 100 years ago, at the dawn of the 20th century, when lending to urban, working-class households first grabbed newspaper headlines and the attention of progressive reformers. Although pawnshops or "hock shops" had existed for centuries, other forms of small-sum lending grew rapidly only after the Civil War, when an increasing number of households became dependent on wage labor for their support. For wage workers, small loans offered a means of scraping by when they suffered inevitable bouts of unemployment or were otherwise in need of cash. Borrowers could assure lenders

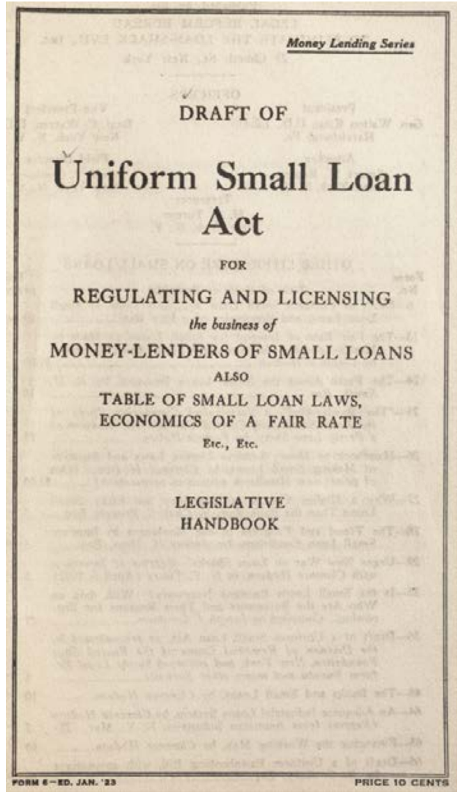
that their debts would be repaid from their future wages.

By 1900, "chattel loans," cash advances secured by a lien on the borrower's personal property, and "salary loans," secured by an assignment of the borrower's future wages, had become a common source of credit for urban, working-class laborers. Buying goods "on time" or "on installment" had also grown to be part of everyday life. Merchants sold clothing, furniture and sewing machines on credit to working-class buyers, who agreed to pay back the sales price plus credit charges in regular installments, and risk repossession of their purchases if they failed to repay the debt.

In this period, the law governing household loans was ancient and varied from state to state. Even as legal control over other matters of economic life had begun to move from the states to the federal government, a hodgepodge of state and local law continued to govern the business of making and collecting small loans in the early 20th century.

Small cash loans were essentially outlawed in most states because of restrictive lending laws that dated back to the 19th century. Lenders could not make a profit if they charged interest at the low rates allowed under these statutes, known as "usury laws." In contrast, selling goods "on time" was hardly regulated at all, thanks to a longstanding legal distinction between cash loans and sales credit. Although merchants often charged one cash price to customers who paid upfront and another to customers buying on time, the law did not treat the difference between these prices as interest on a loan under the judge-made "time-price" doctrine. Cash loans were subject to state usury laws, but sales of goods on time were not.

Over the course of the 20th century, however, the states adopted new rules to govern small-sum lending, through a process that was both national and, yet, highly localized. Nationally, lenders formed professional trade associations to lobby for their interests, and the largest companies operated branches across multiple states. Reformers likewise founded large national organizations, as well as nationwide federations of local groups, to draft legislation and lobby for change. These groups then attempted to guide the development


Money Lending Series

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Uniform Small Loan Act

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MONEY-LENDERS OF SMALL LOANS

ALSO

TABLE OF SMALL LOAN LAWS, ECONOMICS OF A FAIR RATE

Etc., Etc.

LEGISLATIVE HANDBOOK

FORM 6—ED. JAN. '23

PRICE 10 CENTS

Draft of the Uniform Small Loan Act, 1923.

of lending regulations across the country, often through the creation of model state laws drafted by experts in the field. Legal localism persisted, however.

Even after the New Deal's reconfiguration of federal-state relations in the 1930s and the growth of the federal government in the decades that followed, the states retained primary authority over small loans. As a result, each state followed its own course, but often in imitation of a model law or another state's strategy. Most began by limiting the reach of creditors seeking to collect unpaid debts before eventually enacting substantive rules restricting loan terms and then, finally, wrestling with the problem of how to ensure the law's enforcement. The phases of small sum lending regulation also tracked shifting ideas about the proper role of the state in the marketplace, as well as changes in the relative strength of state and federal regulatory power.

The Uniform Small Loan Law drafted in the 1910s, for example, reflected that era's faith in the ability of expert reformers to curtail abusive business practices and the reformers' trust in the power of better legal infrastructure to enable the flow of private capital into the market. The law also affirmed the traditional primacy of the states in regulating this form of commerce. Indeed, even after the federal government joined the fray in the 1960s and then reduced the states' power over some forms of lending in the decades that followed, the states still retained significant authority over the governance of small loans.

For most of the past century, campaigns for the adoption and enforcement of new lending rules played out in dozens of statehouses and in hundreds of state and local courthouses, rather than in a few centralized venues. In each state, local players and state-level political dynamics could shift the balance in deciding when and how to police small-sum loans, and so the tempo and rhythm of legal change varied considerably from place to place.

To date, historians of law and American capitalism have underemphasized the challenges of state-level economic governance in the modern era. The literature on the legal history of 20th-century capitalism is large and growing, including studies on diverse topics such as taxation, the stock market, long-haul trucking and consumer credit.

Yet, although there is a rich body of work on state and local governance of the marketplace during the 19th century, most historians of the 20th century have focused on national state-building and federal economic regulation, particularly when considering the 1930s and subsequent decades. They have shown how national policy privileged particular groups and forms of economic growth, and shaped middle-class markets for housing, labor, education and consumer goods. But even as the federal government expanded over the course of the century, states and localities retained primary control over many key aspects of commercial life, operating within the American system of divided regulatory authority known as "federalism."

Federalism is the first of three reasons why governing small-sum lending has proved to be especially tricky over the course of the past century. Cash lenders and their capital have been able to move easily across state boundaries, operating in one jurisdiction while lending to borrowers elsewhere by mail. Lenders' mobility, coupled with the limited authority

of states to police activities outside their own borders, has made governing the small-sum lending industry within a federal framework especially challenging. The stickiness of the problem became apparent in the early 20th century, when states such as New York attempted to prevent lenders from charging their residents more than the state's maximum interest rate of 6% per year. Lenders soon discovered a loophole, however, setting up shop in neighboring states with lax usury laws and sending money and legal documents to borrowers through the mail. The differences in how each state treated the same transaction created incentives for lenders to shift the legal location of their transactions in order to escape unfavorable regulations, a process known as "regulatory arbitrage."

So began a game of whack-a-mole, as restrictive states beat down one form of illegal lending only to find another popping up in a different corner. State-by-state campaigns for the adoption of uniform lending laws represented one means to combat arbitrage and rein in high-rate lenders. Even in the absence of a uniform or model law, states also learned from one another as they drafted and updated their lending rules, with states such as New York leading the charge.

And, over the course of the century, the states made much progress, with many adopting uniform rules for small cash loans and imitating one another's laws on credit sales. But they found themselves almost back at square one by the early 1980s, when a United States Supreme Court decision and subsequent legislative changes further limited state authority over national banks and the small-sum lenders that partnered with them.

Second, governing small loans has been difficult because policymakers have struggled to draw appropriate regulatory categories, with the goal of treating similar activities similarly and different activities differently. This line-drawing or categorization problem has taken several different forms over the course of the past century. For example, policymakers have been unable to decide whether small loans should be regulated just like other forms of credit or merit their own specially tailored rules. Before the rise of the small-sum cash lending business in the 1890s, the law did not draw a distinction between big loans and small ones. The same usury laws applied across the board; only pawnshops were subject to a special set of regulations. But in the 1910s, the drafters of the Uniform Small Loan Law proposed that small cash loans—defined as loans under $300—should be governed by their own rules, which would allow charges greater than those permitted under most state usury laws. Proponents of the law persuasively argued that a higher rate of charge was necessary for small-sum lenders to recoup their fixed administrative costs, manage the risks of small-sum lending and earn a profit.

Although the uniform law was widely adopted in the 1920s and 30s, it also provoked strong opposition from populist politicians like Mayor Fiorello LaGuardia of New York City, who claimed that the law permitted "legalized usury" and was a boon to the small loan "racket."

LaGuardia saw no need to allow small-sum lenders to charge higher rates than those permitted for commercial banks. Since then, lawmakers have vacillated between two poles, sometimes treating small loans as a special category of debt and sometimes regulating them just like any other form of consumer credit.

Policymakers confronted a similar categorization puzzle when deciding how to regulate cash loans and the sale of goods on credit. They wrestled with whether or not the law should distinguish between these two types of transactions, and the related questions of what constitutes a "loan" or "interest" on a loan. At the beginning of the 20th century, the law drew a sharp distinction between interest on a cash loan, which was strictly limited in most states, and the charge for a sale of goods on the installment plan, which was not. The different legal treatment of these two forms of lending then created incentives for lenders to evade unfavorable regulations by disguising a cash loan as a credit sale. Lenders regularly engaged in this form of regulatory arbitrage, which put pressure on policymakers to discard longstanding legal distinctions between the two transactions. As a result, the laws governing cash loans and credit sales slowly converged over the course of the past century. Yet the distinction between sales credit and cash loans did not disappear entirely, as reflected in the different legal treatment of payday loans versus rent-to-own transactions.

Finally, small-sum loans have been especially tricky to govern because their regulation has been bound up with the problems of poverty and poor relief, which have compounded the complexity of the puzzle. To policymakers, small-sum lending has exemplified both the promise and the perils of modern American capitalism for low-income households. On the one hand, small loans have promised low-wage workers a measure of independence from state support and entry into the growing consumer economy. Credit has served as a private safety net, allowing workers to manage financial shortfalls and make big-ticket purchases without the aid of public welfare or private charity. On the other hand, workers' need to borrow has also symbolized the failure of the economic system to lift up all households.

The high demand for small loans has repeatedly made clear that the rising tide of American prosperity has left some boats grounded on the shore. Furthermore, onerous debts may increase demands on the state for poor relief, turning self-supporting families into public charges. Critics have labeled the business a "racket in human misery" and the purveyors of these products "loan sharks." Thus, the link between small loans and poverty has justified both tightening and loosening the reins on the lending industry, pulling policymakers in opposing directions. At some moments, policymakers have supported the small loan industry; at other times, they have treated small loans like a species of vice, unsavory and barely tolerated.

Which impulse predominates at any given moment has depended, in part, on which lenders serve as the public face of the industry and how they encounter reformers and policymakers—as partners in formulating regulation or as adversaries in litigation. Attitudes have also changed over time depending on public awareness of the peculiar economics of small-sum lending, the availability of other sources of credit and their regulation, levels of public concern about poverty and prevailing ideas about the proper relationship between the state and the market. These changing ideas and attitudes, combined with the work of consumer advocates,


New York City Mayor Fiorello LaGuardia strongly opposed the Uniform Small Loan Act, as he claimed it permitted "legalized usury" and was a boon to the small loan "racket."

state officials and industry insiders, have regularly yielded new laws governing small loans, which then produce fresh problems of implementation and interpretation as the law has journeyed down to the street level—into local loan offices, retail stores, courthouses and government agencies.

Over time, one thing has remained constant—the search for a way to govern small-sum lending has always led back to the law. Today, as in the past, many Americans remain confident that the right regulation can fix fringe finance. The only question is how. For present-day policymakers, the past does not yield a definitive answer to this complicated question. Rather, these stories underscore how tricky it has been to devise a solution to the small loan problem over the past century.

But knowledge of this history can help policymakers to sidestep some of the challenges that have stymied prior attempts at reform, while expanding our collective sense of what is possible. Through reclaiming some of the richness of past policy experiments and reconstructing legal and commercial worlds that bear little resemblance to our own, this history deepens our understanding of how law works in practice and how legal change occurs over time. Our current regime of regulation for small loans is not the only one imaginable. The small-sum lending market has always been constituted through law, but the rules of the game have changed from decade to decade through the work of judges and legislators, borrowers and lenders, lawyers and law reformers.

If history teaches us nothing else, it is that the past is not insurmountable. As historian Michael B. Katz once wrote, we study history not to be trapped by it "but to transcend it." The search for justice within capitalism will continue, but what came before need not dictate what will follow. $

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Exerpt adapted from *City of Debtors: A Century of Finance* by Anne Fleming, published by Harvard University Press.

DRUMMING UP BUSINESS

Gregory Smith

In 2020, the EPA turns 50 and Superfund turns 40. Their effects on business have been almost as big as their effects on the environment.

By Gregory DL Morris

Even though there are some calls to roll back environmental regulation in the name of profitability, a growing consensus within industry and finance believes that cleaner is better in the long run. Institutional investors from private equity to sovereign wealth and pension funds now scrutinize stewardship and sustainability just as thoroughly as they do balance sheets and growth plans.

From a basic economic standpoint, environmental degradation is the same "tragedy of the commons" well documented from grazing lands in Medieval England to post-war oilfields in Texas. Still, it took flagrant dangers to public health and safety coming to a head in the 1970s to drive Congressional action, most notably a toxic waste dump in western New York with the ironic name of Love Canal.

Environmental Protection Agency (EPA) workers at a designated Superfund site near the Houston, Texas area.

In response, Congress established the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), commonly known as Superfund, on December 11, 1980. It created a tax on the chemical and petroleum industries and provided broad federal authority to respond directly to releases or threatened releases of hazardous substances that may endanger public health or the environment. Over just the first five years, $1.6 billion was collected, and the tax went to a trust fund for cleaning abandoned or uncontrolled hazardous waste sites.

Superfund authorizes and funds the US Environmental Protection Agency—itself only created under the Nixon administration in 1970—to remediate contaminated sites. At the very least, that means stabilizing and securing them; if possible, the ideal is to return them to some beneficial use. Importantly, Superfund also forces the parties responsible for the contamination to either perform cleanups or reimburse the government for EPA-led work. When there is no viable responsible party, Superfund gives EPA the funds and authority to clean up contaminated sites.

The initial mandates to EPA are well understood: protect human health and the environment by remediating contaminated sites, and make responsible parties pay for the work. It is less commonly known that CERCLA also mandates that communities be involved in the Superfund process, and that sites are to be returned to "productive use."

Joint and several liability is a major legal lever in forcing responsible parties to pay for remediation. In for a penny, in for a pound. Ironically, that provision quickly became an equally major impediment to the last mandate, return to productive use. Superfund sites became literal, figurative and legal tar pits. Developers would not go near them even in prime locations for fear of being on the hook for all the work.

One recent example is just a few miles from Wall Street on the other side of the East River. The Gowanus Canal in Brooklyn was notoriously noxious for decades. EPA proposed Superfund listing in 2009

as gentrification drove interest in cleaning it. However, many local residents and businesses fought against Superfund listing because of the stigma. Nevertheless, it was listed in 2010.

No one wants to live or work near a toxic property, but neither is anyone too keen to cozy up to a Superfund site. At Love Canal and in many other cases, residents were eager to be bought out and start fresh elsewhere. In other cases, the sites themselves were remote.

"If you put a pencil mark at the middle of the Marcellus and the Utica shale formations, that is my hometown in northern West Virginia," said Phil Lookadoo, a partner in the law firm of Haynes & Boone with practice in energy transactions, regulatory compliance in oil and gas, power and renewables, commodity trading and derivatives, mergers and acquisitions, as well as project finance and development.

"It was an incredibly dense industrial area for a century," he elaborated, "but most of that has been knocked down in recent decades. That has left a lot of brownfield sites. Innovation in environmental liability and indemnification insurance could be transformational. Eventually a hilly region like that runs out of flat land and you have to use whatever you've got. If there is a tangible prospect of long-term value, then people will invest."

As vexing as those brownfield challenges remain, the situation would be much worse if not for Superfund and other similar federal and state legislation. "Superfund has to be judged to have been successful," said Lookadoo. "If not for that liability, so many sites would never have been remediated."

As an example, Lookadoo described a hypothetical site where 80 years ago there had been a coal-tar plant making illuminating gas and petrochemicals. The waste was buried. Decades later a service station was built on the site, but later abandoned when the interstate highway went elsewhere. The fuel tanks were left in the ground. They rusted out, releasing gasoline, which seeped into the coal waste and then into the groundwater.

"At the time the people who built and then left those facilities did not think they were doing anything wrong," Lookadoo explained, "and under the laws and practices at that time, they were not. Now we know better. To get such sites remediated, governments and attorneys went after whomever had deep pockets, and of course they fought it. Most times it got sorted. Without Superfund and the related environmental statutes, that may never have been done."

David Overstreet has been an environmental attorney for more than 25 years. He left full-time practice to form a boutique firm that handles decommissioning and transition work more as project managers than attorneys. He noted that over previous decades there have been waves of disputes and litigation over environmental liability and insurance coverage, mostly by owners trying to transfer risk and underwriters working just as diligently to prevent it.

More recently, however, there have been initiatives by owners of brownfield sites jointly with developers, lenders and insurance companies to get contaminated areas back into beneficial use through preplanned transfer of liability. The essential points are a practical remediation plan and funding, supported by indemnification and insurance.

"There has been an attempt to move beyond the battles over exclusion and into inclusion of associated risks," said Overstreet. "None of the components are new. There has always been the contractual opportunity to transfer liability, and insurance for environmental exposures, and of course capital for development or redevelopment."

Mostly those operated separately, or at worst, in opposition. One of the sharpest arrows in the laws, joint and several liability, became in some instances an impediment to new plans and new money being willing to engage.

"People struggled with how to implement remediation plans," said Overstreet. "Now insurance brokers, underwriters, lenders and developers are finding ways to assemble the layers. There is the contractual shifting of liability, with the corresponding indemnification, all backstopped by the insurance with the liabilities specifically included rather than excluded."

It is a measure of how far Superfund has come in its 40 years that the majority of discussion is now about return to beneficial use. In the dark days of the late 1970s and early 1980s, it seemed a long shot that even federal intervention could turn the tide against decades of corporate irresponsibility and lack of local regulation.

Love Canal is actually in Niagara Falls, New York. The proximity does not seem

Environmental Protection Agency

"Danger, Hazardous Area" sign as seen through a chain link fence at Love Canal containment zone, near Niagara Falls, New York.

to have done anything to harm the romantic if kitschy reputation of the town or the natural grandeur of the falls.

Love Canal was one of two initial excavations for what was to be a canal to provide inexpensive hydroelectric power for industrial development around the turn of the 20th century. Ultimately, with the triumph of alternating current (championed by enigmatic genius Nikolai Tesla) over direct current (promoted by Thomas Edison), the canal excavation was abandoned. It filled naturally with water as many disused quarries and mines do.

Between 1942 and 1953, Hooker Electrochemical disposed of more than 21,000 tons of hazardous chemicals into the abandoned Love Canal, contaminating the soil and groundwater, according to the EPA official history of the site. In 1953, the landfill was covered with soils and leased to the Niagara Falls Board of Education. Afterwards, the area near the covered landfill was extensively developed, including construction of an elementary school, as well as many residential properties.

During the 1960s, complaints about odors and residues were first reported at the Love Canal site. In 1968, Hooker was acquired by Occidental Chemical Corp., subsidiary of the eponymous petroleum company.

Reports of contamination increased in the 1970s as the water level rose, bringing contaminated groundwater to the surface. Various federal and state studies indicated that numerous toxic chemicals, including dioxin, had migrated through

"Valley of the Drums" in Brooks, Kentucky, was placed on the National Priorities List in 1983 due to contaminated groundwater, soil and surface water.

existing sewers and, ultimately, drained into nearby creeks.

In late 1977, in response to complaints from residents of homes adjacent to the Love Canal landfill, the EPA and New York State Department of Environmental Conservation began investigating the groundwater at the site, as well as indoor air and sump water contamination in residences.

In August 1978, President Jimmy Carter issued the first of two emergency declarations regarding the Love Canal site. The first provided federal funding for remedial work to contain the chemical wastes and to assist the state in relocating residents.

On May 21, 1980, President Carter issued a second emergency declaration, specifically establishing the Love Canal Emergency Declaration Area (EDA), a 350-acre neighborhood surrounding the landfill. The second declaration authorized $20 million in federal funds to purchase homes, with matching state funds. The EDA was ultimately divided into seven separate areas surrounding the landfill, which were eventually assessed as to their habitability.

The Federal Emergency Management Agency (FEMA) managed the property purchase, disbursed funds and relocated hundreds of families. New York State, including the Love Canal Area Revitalization Agency, collaborated closely with FEMA. All but two families were evacuated and, in 1982, most structures were demolished. The debris was placed under the Love Canal landfill cap.

The fenced 70-acre site today includes the original 16-acre hazardous waste landfill and a 40-acre cap, as well as a barrier drainage system and leachate collection and treatment system. The severity of the site's contamination ultimately led to the creation of federal legislation to manage the disposal of hazardous wastes throughout the country, CERCLA.

In September 2004, the EPA removed the site from the Superfund program's National Priorities List. As a result of the revitalization efforts of the Love Canal Area Revitalization Agency, new homeowners have moved into the habitable areas of the Love Canal site. More than 260 formerly abandoned homes in the affected area were rehabilitated and sold to new residents, creating a viable new neighborhood.

In a clear indication of how Love Canal embodied industrial contamination in the mind of the public, the *Los Angeles Times* published a news feature in 1994 detailing the $98-million settlement between the state and the company.

"Taking a big step toward closing a case that raised the nation's concern about buried toxic waste, Occidental Chemical Corp. agreed to pay the state of New York $98 million to settle one of the key civil lawsuits over Love Canal," wrote the *Times*. "The company also agreed to take over monitoring and cleanup of the Niagara Falls, NY, neighborhood – a chore that the New York attorney general's office estimates will cost an additional $25 million over the next 30 years. Nearly 500 families in the Love Canal neighborhood, built atop nearly 22,000 tons of waste chemicals, evacuated in panic in 1978 after the toxic substances were blamed for a variety of birth defects and illnesses."

Although less well known than Love Canal, the site with the chilling moniker of "Valley of the Drums," in Kentucky, is important because it demonstrated how important the broad powers of Superfund became quickly after being enacted. The 23-acre dump, formally known as the AL Taylor site, is in Brooks, KY. It includes an area used for waste disposal and drum recycling. The EPA placed it on the National Priorities List in 1983 because of contaminated groundwater, soil and surface water.

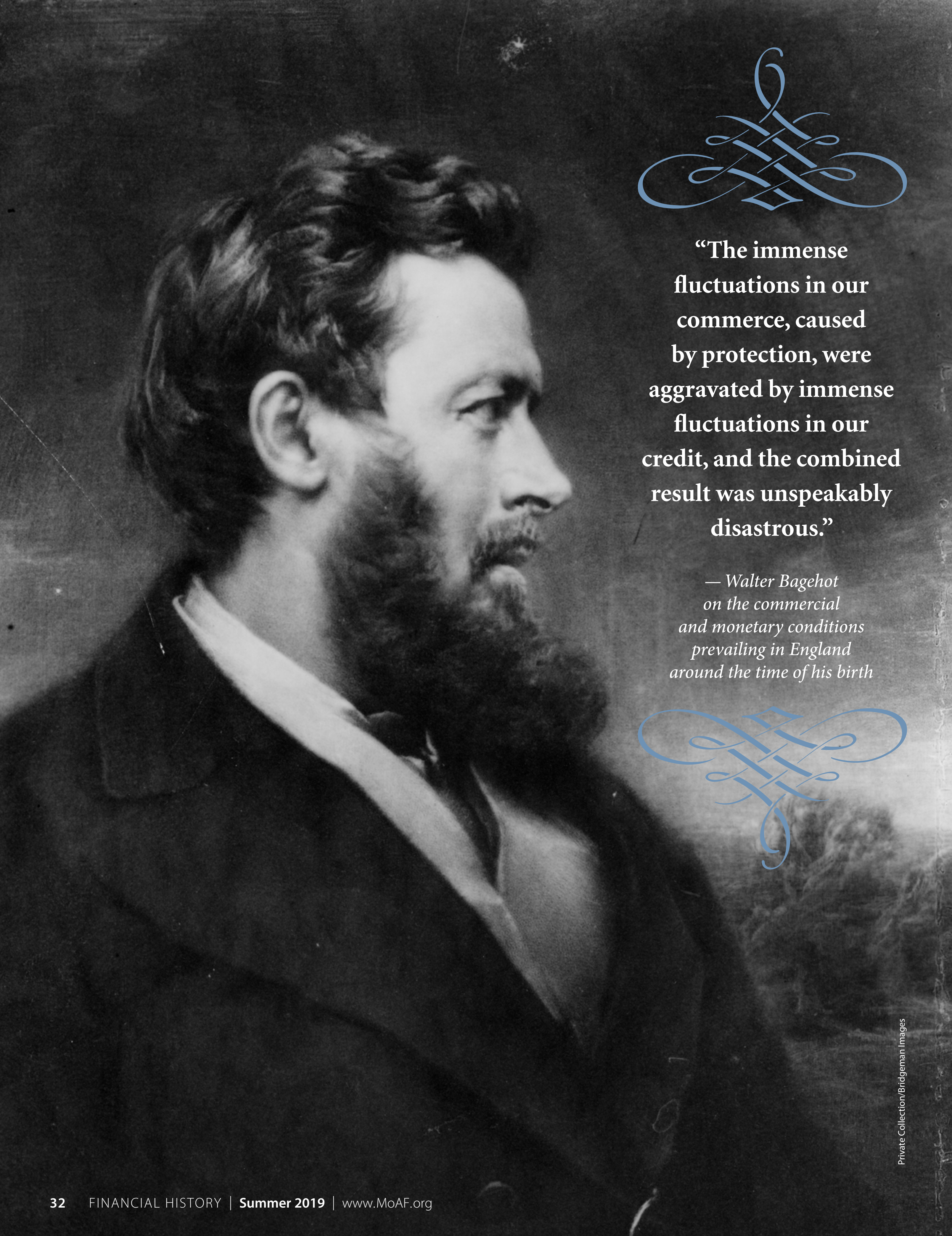
It also became a powerful visual image. All the Love Canal contamination was underground, and the area looked like any other suburb with homes, parks and a school. While the images of abandoned playgrounds were haunting, they were not sensational. It was the monstrous sights from the Taylor dump—stacks and piles of drums sprawling over acres amid pools of waste and foul water—that became the shocking poster images of contamination and neglect.

The Taylor site is a rural area with woods and grassy sections 10 miles south of Louisville. The owner used the site for waste disposal operation from 1967 to 1977 when he died, leaving title to the land unclear.

EPA records show the state first documented releases of hazardous substances from the site in 1975 and pursued legal action against the owner. However, local reports indicate some of the waste caught fire in 1966 and burned for days. In 1978, a state investigation found that more than 100,000 drums of waste were delivered to the site, of which 27,000 were buried; the rest were dumped into pits.

In 1979, large quantities of contaminants were carried into the creek by the spring snow melts. At the request of the state, the EPA conducted emergency response actions to prevent the migration and future releases of contamination. The EPA recorded more than 17,000 drums still at the site, of which only two thirds were empty. Remediation took about seven years. $

Gregory DL Morris is an independent business journalist, principal of Enterprise & Industry Historic Research (www.enterpriseandindustry.com) and an active member of the Museum's editorial board.



“The immense fluctuations in our commerce, caused by protection, were aggravated by immense fluctuations in our credit, and the combined result was unspeakably disastrous.”

— Walter Bagehot on the commercial and monetary conditions prevailing in England around the time of his birth

Private Collection/Bridgeman Images

THE GREATEST VICTORIAN Walter Bagehot

By James Grant

In 1832, Jeremiah Harman, a long-serving director of the Bank of England, testified before a parliamentary committee on how the Bank rose to meet the occasion of the Panic of 1825. It was a desperate time, and the Bank lent money in unprecedented ways.

"We lent it by every possible means, and in modes that we never had adopted before," Harman explained;

> we took in stock as security, we purchased exchequer bills, we made advances on exchequer bills, we not only discounted outright, but we made advances on deposit of bills of exchange to an immense amount; in short by every possible means consistent with the safety of the Bank; and we were not upon some occasions over nice; seeing the dreadful state in which the public were, we rendered every assistance in our power.

Bagehot (pronounced Badge-it), who wrote the still-canonical prescription for stopping a run on the banks, *Lombard Street*, never recommended a policy so extreme. Faced with a crisis, he famously asserted, a central bank should lend freely at a high rate of interest against good banking collateral. He said much more than that, but those words—customarily abbreviated to omit the part about the high interest rate—are invoked to this day. No sooner do the banks bring down a crisis on themselves, or stock prices take a tumble, than the call goes out for the Federal Reserve to infuse the market with emergency credit. In his memoir of the Great Recession, *The Courage to Act*, Ben S. Bernanke, chairman of the Federal Reserve from 2006 to 2014, cited Bagehot more frequently than any living economist.

Bagehot was a banker, a man of letters and a financial journalist; most famously, he edited the *Economist*. But he was no economist himself—that is, he made no original contribution to the body of economic theory.

It is a comment on the nature of economics as much as it is on the genius of Bagehot that his dicta on central banking continue to hold sway almost a century and a half after he propounded them. In the physical sciences, progress is cumulative; we stand on the shoulders of giants. In economics, the most ostensibly rigorous of the social sciences, progress—and error, too—are cyclical; we keep stepping on the same rakes.

There is a misconception that Bagehot originated the idea of a lender of last resort. It's obvious he could not have done so; Jeremiah Harman and his fellow directors were doing more than Bagehot would later recommend two months before the author of *Lombard Street* was even born. He did, however, popularize and legitimize the proposition, controversial at the time but now taken as revealed truth, that a central bank owed a public duty to private persons dealing with large sums of money. Unfortunately, he seriously underestimated the extent to which this supposed obligation would induce people to take risks they would not otherwise accept in the absence of expected government help.

Perhaps Bagehot himself would agree. He believed—at least, at age 39, when a monetarily astute friend took the trouble to make a careful inventory of his views—that money was gold and silver and that alone. All forms of currency, including the notes of the Bank of England, were credit instruments, no different than personal checks, from which it followed that the government had no business intervening in the business of banking. Bagehot came to modify his ideas about financial regulation—but, unacknowledged by the many who approvingly quote him on the imperative of central bank crisis management, he never changed his publicly expressed view about the gold standard or the abomination of fiat currency.

Bagehot was not the only virtuoso writer on money and banking in 19th-century England: Karl Marx, London correspondent for the *New York Tribune*, was an accomplished financial reporter (bear markets brought out the best in him). George Goschen's brilliant matched set of essays, "Two Percent" and "Seven Percent," can be read for sheer pleasure—no small feat considering the subject matter is interest rates. Yet Bagehot—eclectic, fearless, aphoristic, prolific—stands apart.

The 20th-century American journalist A.J. Liebling said of himself that he wrote faster than anyone who wrote better, and better than anyone who wrote faster. Bagehot made no such claim—it would have been un-English. But with a glance at periodical journalism in the 1850s, 1860s and 1870s, the boast would have been defensible.

An adviser to statesmen, notably the Liberal parliamentarian and long-serving prime minister William E. Gladstone, he himself failed to win election to Parliament in three attempts. Nor did he make a fortune in the City of London. His writing is what secured his reputation. As a financial journalist, the editor of the *Economist* possessed another, apolitical virtue: his paper was evidently incorruptible.

Bagehot himself, like many in the age before antibiotics, was susceptible to bronchial disease—yet during the period of his worst illness, he produced his most celebrated work. In sickness or health, he wrote as few have ever written, before or since. $

James Grant, financial journalist and historian, is the founder and editor of Grant's Interest Rate Observer, *a twice-monthly journal of the investment markets. His book,* The Forgotten Depression, 1921: The Crash That Cured Itself, *a history of America's last governmentally unmedicated business-cycle downturn, won the 2015 Hayek Prize of the Manhattan Institute for Policy Research.*

This article was reprinted from *Bagehot: The Life and Times of the Greatest Victorian*.

WHERE ARE THEY NOW?

Paine, Webber, Jackson & Curtis

By Susie J. Pak

The son of a clergyman, William Alfred Paine was born in Massachusetts in 1855. His father, Reverend Albert Paine, a Massachusetts native, was a clergyman who served as a chaplain in the Civil War. Paine was educated in public schools in Massachusetts, Wisconsin and Illinois as his family moved to the West and the Midwest. They eventually returned to the East Coast, and when Paine was about 18 years old, he started working as a clerk in the Blackstone National Bank of Boston in 1873.

Paine & Webber (f. 1880, Boston)

In 1880, William A. Paine founded the firm of Paine & Webber in Boston with partner Wallace G. Webber. A Massachusetts native, Wallace Gleason Webber was educated in public schools in Bedford and a commercial college in Boston. His father, Marcus B. Webber, was a Massachusetts native and a grocer by trade. Like Paine, Wallace Webber had also worked as a clerk at the Blackstone National Bank. He started at the bank in 1874 as a messenger.

Photograph of the offices of Paine, Webber & Co., circa 1920.

Paine, Webber & Co. (f. 1881, Boston)

When Charles H. Paine, William's older brother, joined the firm in 1881, the firm changed its name to Paine, Webber & Company. Wallace G. Webber became a member of the Boston Stock Exchange that year. In 1890, Charles H. Paine purchased a seat on the New York Stock Exchange (NYSE). The firm was badly hit by the Panic of 1893, but it survived because it had made a fortunate investment in the copper industry. In 1898, William Paine also founded the Copper Range Company, in which he remained president until his death in 1929. In 1894, Wallace G. Webber retired from the firm, but his name continued to be used in the partnership. Charles H. Paine retired in 1906, and his seat was transferred to William A. Paine in 1905. William A. Paine remained the head of the firm until 1929 when he suddenly died. His seat on the NYSE was then transferred to Herbert I. Foster, who joined the firm in 1898 and became a partner in 1902.

In the late 19th and early 20th centuries, the firm expanded by opening offices, first in the Midwest, and as it grew, admitted partners and joined more exchanges, also starting in the Midwest. It opened an office in Houghton, Michigan, a copper mining town, in 1899. It opened a Minneapolis office and a Duluth, Minnesota office in 1902, a Detroit office in 1909, a Chicago office and a Worcester, Massachusetts office in 1915, a New York office, a Minneapolis office, and a Springfield, Massachusetts office in 1916, a St. Paul, Minnesota office in 1917, a Philadelphia office, a New Haven office, and an Albany office in 1918, a Grand Rapids office in 1919, a Providence office and a Syracuse office in 1922, a Concord, New Hampshire office in 1927, a Cleveland office and a Flint, Michigan office in 1928. Leonard D. Draper became a partner in 1907. Edward J. Furlong and M.J. O'Brien became partners in 1916. The firm joined the Chicago Board of Trade in 1909 and the Chicago Stock Exchange in 1916. William A. Paine's son, Francis Ward Paine, a 1910 Yale University and 1911 University of Wisconsin graduate, joined the firm in 1919. His other son, Stephen Paine, a 1920 Harvard graduate, became a partner in 1928. By 1930, the firm had 1,300 employees, 14 partners and 25 offices.

During the Great Depression, the firm suffered the decline in the brokerage industry and reduced its offices to 19. Even more seriously, the firm was also caught up in a securities fraud scandal in the late 1930s that led to the conviction of Stephen Paine for mail fraud in January 1939. Paine had allowed three associates—who were not

members of Paine, Webber—to borrow money from the firm to buy control of two investment trusts, Insuranshares Corporation of Delaware and Burco, Inc., and then exchange the $6 million of securities the trusts had for worthless securities.

Stephen Paine was suspended from the NYSE and retired from Paine, Webber, which paid over $1 million in settlement from civil lawsuits. (Another partner, Frank Hope, was also suspended). The court determined that he had been aware of the intentions of his associates and was sentenced to two years in prison. He was let out of prison in May 1940. Three months later, in August 1940, his brother, Francis W. Paine, who was still senior partner of Paine, Webber, was killed in a Boston subway accident when he fell into the track in front of an oncoming train in South Station.


William Alfred Paine, founder of Paine & Webber.

Paine, Webber, Jackson & Curtis (f. 1942, Boston)

In 1942, Paine, Webber merged with Jackson & Curtis, a Boston firm founded in 1879 by Charles C. Jackson, Laurence Curtis and Frank Jackson. Laurence Curtis was born in Boston in 1849. His father was a veteran of the War of 1812 and a Boston merchant. An 1870 Harvard graduate, Curtis worked for the Boston firm of Lee, Higginson & Co. as a clerk. In 1874, he became a member of the Boston Stock Exchange and went into business for himself as a stock and note broker. In 1875, he founded Jackson & Curtis with Charles C. Jackson, a fellow member of the Lee, Higginson firm. A bachelor, Curtis died in 1931, two weeks after the death of his twin brother, Louis.

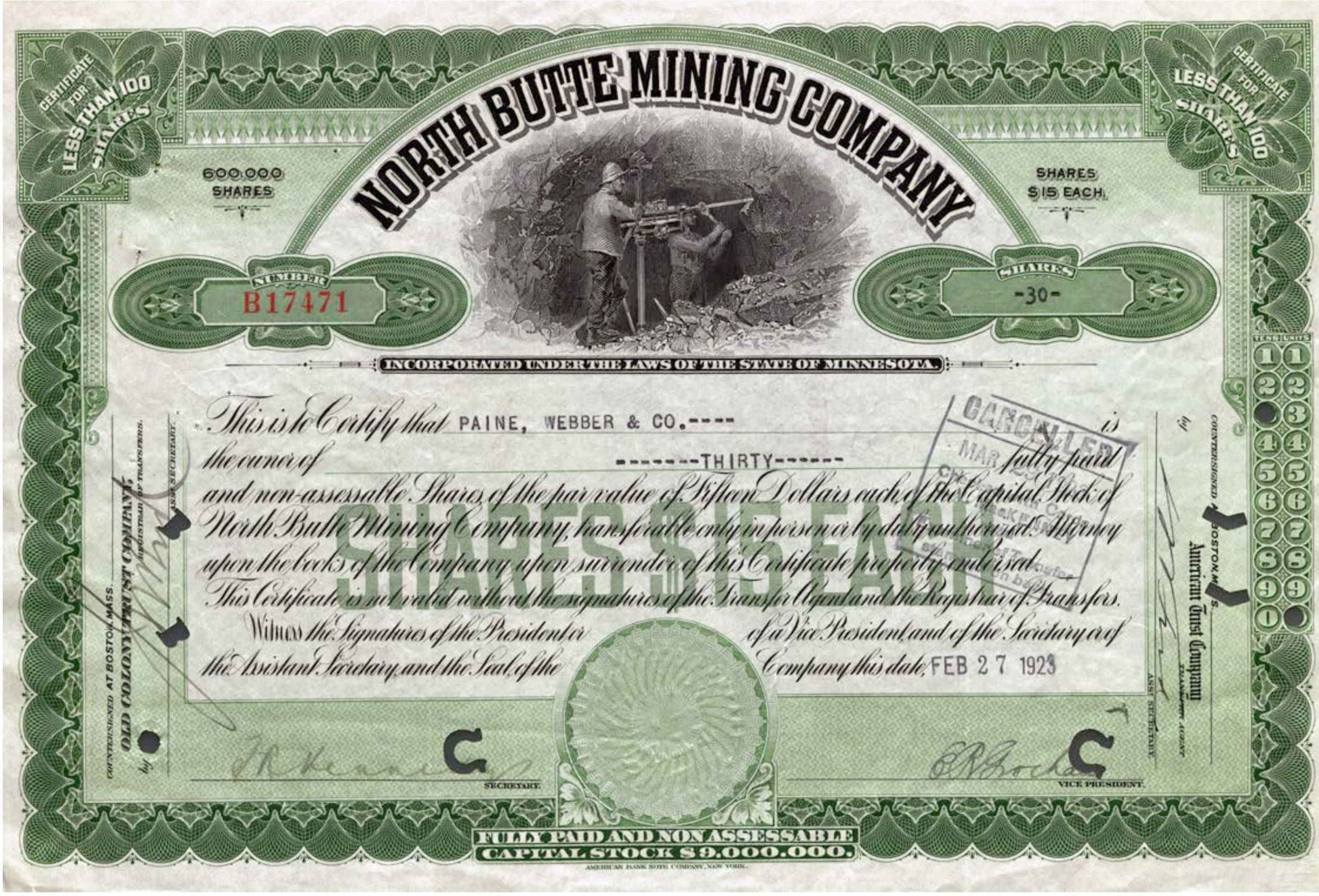
Charles Cabot Jackson was a Boston native and an 1863 Harvard graduate. He was the son of Charles Jackson Jr. and the former Susan Cabot. His grandfather, Charles Jackson Sr., was an associate justice on the Massachusetts Supreme Judicial Court. His father's sister, Amelia Lee Jackson, was married to Oliver Wendell Holmes Sr., a doctor. Their son, Oliver Wendell Holmes Jr., was appointed to the Supreme Court in 1882. Charles Jackson studied mercantile law and engaged in the railway supply business in 1865. In 1868, he founded the Boston firm of Richardson and Jackson, a wool brokerage firm, with G.K. Richardson. In 1870, he joined the firm of Lee, Higginson & Co. and left in 1879 to enter into a partnership with his brother, Frank Jackson, and Laurence Curtis. In 1901, he transferred his NYSE membership to his son, Charles Jackson.

In the post-war, the leadership of Paine, Webber, Jackson & Curtis was dominated by James W. Davant. Born in Mississippi in 1916, Davant was raised in Memphis, TN. He studied at the University of Mississippi and the University of Virginia. After serving in the Naval Air Corps during World War II, he joined Paine Webber, Jackson Curtis in 1945 as a trainee. In 1956, he became the head of the firm's Minneapolis office, and in 1964, he was named managing partner of the firm. The firm had moved its head office from Boston to New York City in 1963. Under Davant's tenure, the firm began to acquire other firms, starting with Barret Fitch North, a Kansas City, MO brokerage house, in 1967. In 1970, the firm became a corporation and bought Abbot, Proctor & Paine, a Richmond, VA securities firm. Two years later, in 1972, the firm went public and bought Abacus Fund, Inc., an investment firm. In 1973, it bought the firms of F.S. Smithers & Co. and Mitchum, Jones & Templeton. In 1974, it bought four offices from the firm of duPont Walston, which was being liquidated. In 1977, it bought Mitchell Hutchins, a brokerage house known for its research expertise.

As managing partner, Davant also expanded the firm overseas and opened offices in London and Tokyo in 1973. During the 1970s, the firm also became well known for its advertising slogan, "Thank you, Paine Webber." By the time he retired, the firm had grown from 40 offices and a capital of $1 million in 1964 to 229 offices and a capital of $240 million.

Blyth Eastman Paine Webber (f. 1980)

In 1979, Paine Webber bought Blyth Eastman Dillon, the securities subsidiary of INA Corporation, an insurance holding company, and the subsidiary was renamed Blyth Eastman Paine Webber. (Blyth Eastman Dillon was the result of INA's merger of two firms in 1972: Blyth & Co. and Eastman Dillon, Union Securities Co.) INA Corporation received "20% of the shares of Paine Webber" in exchange for its 67% ownership in Blyth Eastman Dillon. After selling Blyth Eastman Dillon, INA Corporation reinvested itself in its core business,



Bettmann

Certificate for 30 shares in the North Butte Mining Company owned by Paine, Webber & Co., February 27, 1923.

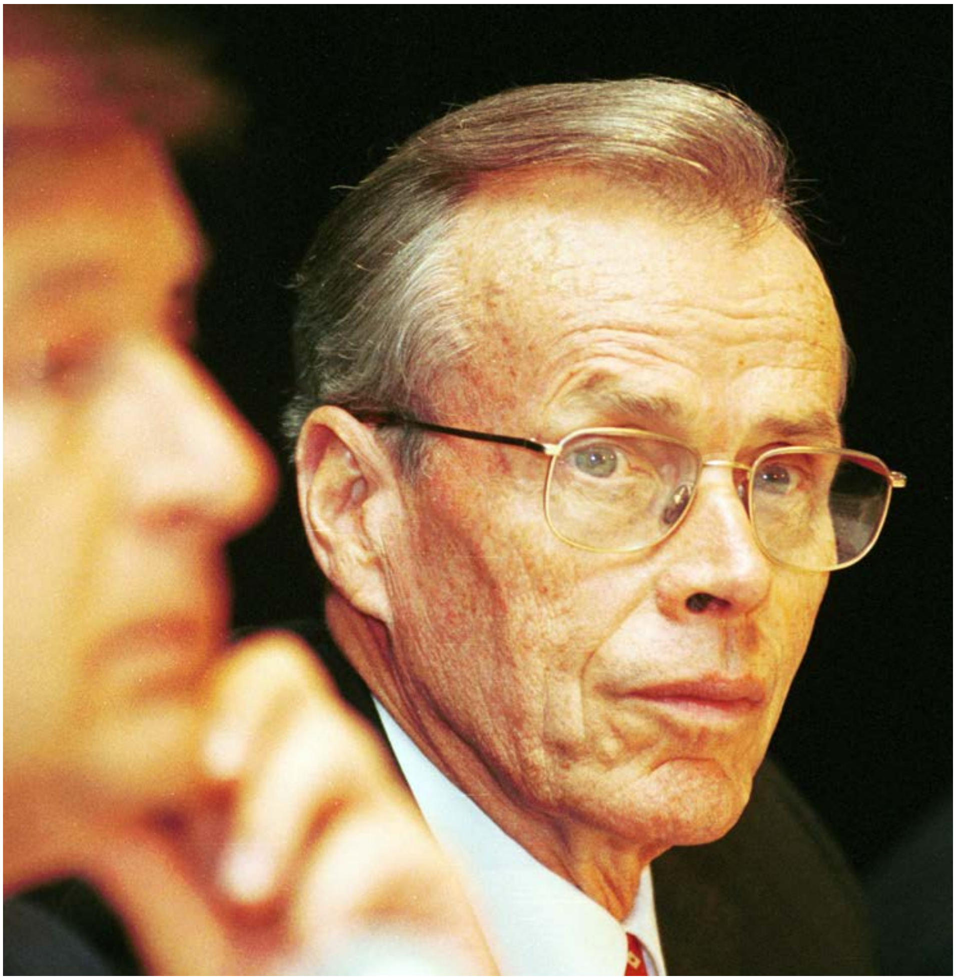
merging two years later in 1982 with Connecticut General Corporation, another prominent insurance company founded in 1865. The company was renamed Cigna. That year, Cigna divested itself of most of its stake in Paine Webber Inc.

By merging with Blyth Eastman Dillon, Davant had hoped to put "Paine Webber on par with the biggest Wall Street players." Unfortunately, the merger did not end well and "proved his undoing." Paine Webber experienced "massive operational problems" that stemmed from issues in reconciling Blyth Eastman Dillon and Paine Webber's processing systems. In an episode reminiscent of the back office debacle of the 1960s, "the acquisition, which coincided with an explosion in stock market volume, overloaded the company's operating systems. Many transactions were lost, and the company, after suspending bond and over-the-counter trading, reported big losses in what should have been a highly profitable year." These problems not only led to a SEC censure, it led to significant financial losses, and key officials left the firm.

Davant stepped down as chief executive of Paine Webber, Inc., the holding company created in 1974, in 1980 and as chairman in 1981. When he left, he told reporters, "Frankly, you get tired after 16 years in this job." Davant's replacement was Donald B. Marron, a New York native and graduate of the City University of New York, who had joined Paine Webber Inc. after selling "his former firm, Mitchell Hutchins [an institutional equity research firm], to Paine Webber in 1977." When Paine Webber Inc. hired Marron, it was "seeking to bolster its reputation in investment banking, public finance and international securities." Marron became head of the firm, which merged with his investment banking firm, D.B. Marron & Co., in 1965.

Michael J. Johnston, a University of Kansas and Harvard Business School graduate, who started at Mitchell Hutchins in 1967 and followed Marron to Paine Webber, became president and chief operating officer of the Blyth Eastman Paine Webber Inc. subsidiary. Johnston also became chairman of the Paine Webber Mitchell Hutchins subsidiary.

Under Marron's leadership as chairman and CEO, the firm responded to the operational crisis by cleaning "up its back office and [cutting] expenses by chopping its work force by hundreds." Under Marron's tenure, Paine Webber continued to expand and diversify. In 1983, it bought Rotan Mosle Financial Corporation, a Southwest securities firm, and First Mid-America, a securities firm located in Nebraska. In 1984, it bought Becker Paribas Futures, a commodity-futures trading firm, and Rouse Real Estate Finance, a mortgage financing firm. That year, it also combined its subsidiaries, Paine, Webber, Jackson & Curtis, Paine Webber Mitchell Hutchins and Blyth Eastman Paine Webber into one subsidiary



Chris Hondros / Staff

Donald Marron, CEO and Chairman of Paine Webber, announces at a press conference that Paine Webber will merge with UBS, July 12, 2000.

called PaineWebber Incorporated and created a parent holding company called PaineWebber Group Inc.

Marron said in 1986 that he hoped to "propel Paine Webber into the 'bulge bracket'-Wall Street argot for the top five or six investment banking houses that garner most of the major deals." But by 1987, *The New York Times* reported that he was "scaling back his vision" for the firm. After the firm suffered setbacks during the 1987 stock market crash, the firm began to sell some of its operations to other firms, starting with its commercial paper operation to Citicorp in November 1987 and its venture capital unit in January 1988. It was bought by the unit's managers. It also sold 18% of its equity interest to Yasuda Mutual Life Insurance Company in November 1987 and used the capital to buy Manufacturers Hanover Investment Corporation in 1988 in an attempt to move into merchant banking, though that was ended soon after.

In 1994, the firm moved to build up its investment banking services and bought Kidder, Peabody & Co. from General Electric Co., which gained a 25% stake in PaineWebber. That year, Joseph J. Grano Jr. succeeded Marron as president of PaineWebber Group. He had been the head of the firm's retail unit since 1988. Marron became chairman and CEO. The following year, amid rumors that the firm would be sold, Marron wrote a letter to PaineWebber employees stating, "We continue to be staunchly independent and are proud of our heritage as one of the very few such firms left in our industry."

According to the *Wall Street Journal*, the merger of Morgan Stanley Group Inc. and Dean Witter, Discover & Co. in 1997 put enormous pressure on PaineWebber. The paper reported, "The deal underscores PaineWebber's quandary: as its major US brokerage rivals have become bigger and have diversified into investment banking and other financial services, PaineWebber risked being left behind because of its focus on the retail brokerage business, which has become increasingly competitive with the advent of low-cost online trading." In 2000, J.C. Bradford & Co., a Nashville brokerage house founded in 1927, bought PaineWebber Group, Inc. (J.C. Bradford bought the Almstedt Brothers brokerage house in 1979). That year, the firm agreed to a purchase by UBS AG, a Swiss bank.

UBS AG (2000)

UBS AG was the result of a 1998 merger between the Union Bank of Switzerland and the Swiss Bank Corporation. It traces its history back to the Bank in Winterthur, which was founded in 1862 and merged with Toggenburger Bank, founded in 1863 in Lichtensteig, in 1912 to form the Union Bank of Switzerland. The Swiss Bank Corporation traces its history back to the Balser Bankverein, which was founded in 1872 in Basel. PaineWebber became the retail brokerage arm of UBS and was renamed UBS PaineWebber in 2001. In 2003, UBS renamed the brokerage division UBS Financial Services and the Paine Webber name was lost to history. $

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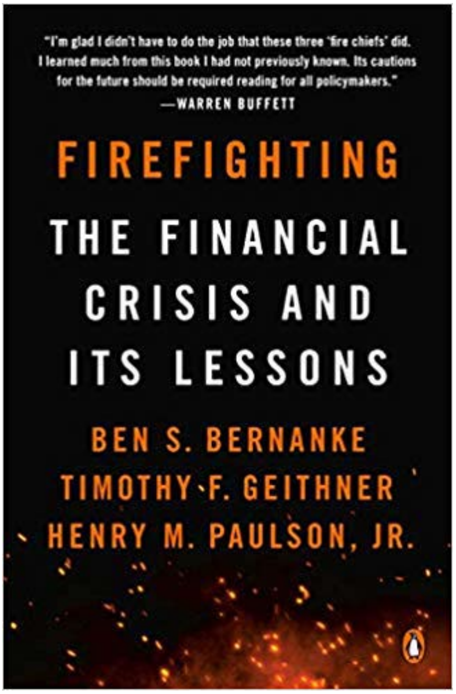
About Where Are They Now? The "Where Are They Now?" Series traces the origins and histories of 207 of the underwriters of the 1956 Ford Motor Company IPO. The research for this series has been generously funded by Charles Royce of The Royce Funds. The Museum's "Where Are They Now?" blog can be found at: wherearetheynowblog.blogspot.com.



Firefighting: The Financial Crisis and Its Lessons

By Ben S. Bernanke, Timothy F. Geithner and Henry M. Paulson, Jr.
Penguin Random House, 2019
129 pages text, 82 pages charts, index

Ten years after the near-immolation of US and global financial markets, the three men who led the effort to contain and control the conflagration have written a superb short history of the devastating events. Despite being brief it is sufficiently detailed, enough indeed to quicken the pulse of any reader as they relate unheeded warnings, infamous acts of venality and the extreme efforts ultimately necessary to battle the crisis. Those efforts took the trio and their departments to the edge of legal authority.

The book is surprisingly well written, brisk and approachable. There is no doubt of the erudition of the authors, but economics is not called the dismal science for nothing. Financial history, even recent history of great and terrible events, tends to be dry. The tone is clear and mostly free of the coded language of bankers and regulators so that any reader can follow the narrative. Still, there is strong and precise terminology for financial professionals. Serious technicians can geek out to the dozens of pages of tables and charts.

It is vitally important that the book is equally relevant to technical and non-technical readers alike, because it delivers urgent warnings. The clear theme of the story is that like Waterloo, the financial crisis was a near-run thing and as bad as it was, it could easily have been much worse. It is plain throughout that even the brightest and most adept firefighters had to scramble and improvise with insufficient tools.

Often the authors clamor for systemic oversight and coordinated responses with adequate apparatus. Ominously they note at the end of the book that the necessary protections, regulations and measures are already being dismantled in the name of growth.

"The Fed has lost its power to rescue individual firms, and faces new constraints on its lending powers, while the Treasury has lost its ability to use the Exchange Stabilization Fund for guarantees," the authors warn. "This has all been done in the name of avoiding government rescues, a worthy goal. But the better way to avoid government rescues is not to hobble the first responders but to avoid crises in the first place. Eventually risk tends to weave its way around even the best designed safeguards. [T]hat is a reason to give crisis managers the authority they need to respond with overwhelming force. You can't wish away fires by closing the firehouse."

This book is remarkable for its straightforward narrative of the crisis, and also for its well-founded warnings. There is surprisingly strong criticism of some companies. Fannie Mae and Freddie Mac get well lashed: "These government-sponsored enterprises had deep influence with both parties in Washington and exploited assumptions that the government would never let them fail to borrow heavily at below-market rates without much of a capital buffer. They were basically the corporate embodiment of moral hazard, enjoying the upside of their risk taking while taking comfort that taxpayers would cover any downside."

Emergency legislation "gave the Treasury and the Fed a chance to look under the hood of Fannie Mae and Freddy Mac, uncovering some ugly surprises. Fed and OCC examiners concluded that both firms were functionally insolvent, with flimsy capital cushions that were mostly accounting fictions."

A term like "accounting fiction" is a polite way of saying fraud, and the reader wonders why no one was held to criminal prosecution. The authors are also at pains to reiterate several times how they set aside punitive measures in the name of resolving the crisis in front of them. There was a near-constant call for haircuts for creditors, but the authors note that such provisions would have made enabling legislation more difficult to pass or enforce.

Similarly, some notorious malefactors in the crisis—such as Angelo Mozilo, the former CEO of Countrywide—are let off with barely a mention. Instead, the authors heap their scorn on the haphazard regulation that was allowed to accumulate, like a jacket of all patches, and on the lack of authority vested in what regulators there were. And while the cats were away, the mice did play.

The near-death experience of Bear Stearns, ultimately acquired by JP Morgan Chase, hardly filled the authors with confidence. "We did not feel triumphant after the Bear rescue," the authors recall ruefully. "We felt uncomfortable. The episode demonstrated how confidence in heavy leveraged and loosely regulated nonbanks with too much short-term funding could disappear in a heartbeat.

"And Bear was not the only financial institution that had borrowed too much and too short with too little oversight, or invested too much in sketchy mortgages and structured credit that nobody trusted anymore….Suspicions were also mounting in the markets that Lehman [Brothers] would be 'next,' which can

be a self-fulfilling prophecy for a financial firm… In fact the entire business model that produced Bear was now under suspicion."

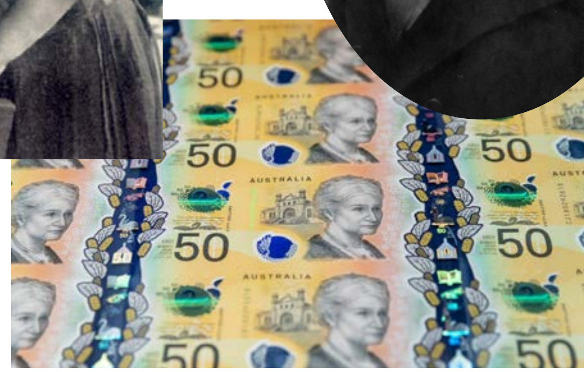
The foot-dragging and outright obstruction of some entities was breathtaking, even once the momentum had turned to recovery and reform. "The Home Affordable Modification Program was a logistical nightmare," the authors lament, "reliant on a dysfunctional loan-servicing industry that routinely lost paperwork, failed to return phone calls, and generally gave borrowers the run-around. Tim's team at Treasury thought about setting up its own servicing program from scratch, but decided there was not enough time, and banks were reluctant to invest in the infrastructure they would have needed to identify the mortgages that were suitable for modifications and get the deals done quickly."

It will take "a long period of less profligate policy choices and benign economic conditions to restore America's macroeconomic firepower to levels that could help end another emergency," the authors caution. "Right now, even a modest recession could leave Washington without much fiscal leeway to respond to a financial crisis, or for that matter upgrade infrastructure, tackle the opioid epidemic, address climate change, stabilize Social Security, or provide permanent tax relief for hard-working families. America was grappling with rising income inequality, middle-class insecurity, and other economic challenges well before the Crisis of 2008. But the crisis made them worse, and unsustainable budget deficits could hobble our ability to deal with them."

Gregory DL Morris is an independent business journalist, principal of Enterprise & Industry Historic Research (www.enterpriseandindustry.com) and an active member of the Museum's editorial board.

TRIVIA QUIZ

HOW MUCH DO YOU KNOW ABOUT FINANCIAL HISTORY?



1. What was the first and only bank run by Black women in the United States?
2. What is the NYSE-listed Minnesota Mining and Manufacturing Company better known as?
3. What banker and editor of *The Economist* is known as "the Greatest Victorian"?
4. What legislation attempted to regulate small sum lending in the early 20th century?
5. What bank president was the most powerful Black woman in the financial industry in the 1920s?
6. What bank served Irish immigrants for generations before demutualizing in 1986?
7. What 19th century Wall Street broker was nicknamed the "Dark Prince" of Wall Street?
8. What word was recently misspelled on more than 46 million of Australia's new $50 bank notes?
9. How many times does "The United States of America" appear on a $100 bill?
10. What first lady has appeared multiple times on paper money?

1. The St. Luke Bank in Richmond, Virginia **2.** 3M **3.** Walter Bagehot **4.** The Uniform Small Loan Law **5.** Maggie Lena Walker **6.** Emigrant Savings Bank **7.** Jeremiah Hamilton **8.** Responsibility **9.** 12 times **10.** Martha Washington